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Archwilydd Cyffredinol Cymru
Auditor General for Wales

Regeneration Investment Fund for Wales

Updated version



WALES AUDIT OFFICE
SWYDDFA ARCHWILIO CYMRU



Addendum

Page 10; paragraph 9

In the original version of this report, the figure of £31.9 million is used. This should read £30.9 million. The version on the Wales Audit Office website has been amended accordingly.

I have prepared and published this report in accordance with the Government of Wales Acts 1998 and 2006.

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Summary



Summary

- 1 The Regeneration Investment Fund for Wales (RIFW) was established in December 2009 as a Limited Liability Partnership (LLP), registered with Companies House and effectively wholly-owned by the Welsh Government. The Welsh Ministers are Members collectively of the LLP and in January 2011 they appointed a RIFW Board comprising five members, two of whom were Welsh Government officials. These five individuals were expected to represent the Welsh Government's interests, alongside their primary responsibilities to the LLP.
- 2 RIFW's purpose is to invest in urban-regeneration schemes across Wales. Its £55 million investment fund at establishment comprised £25 million of European Regional Development Fund (ERDF) convergence funding from the Welsh European Funding Office (WEFO), together with £30 million of funding provided by the Welsh Government itself. The Welsh Government funding comprised £9.4 million of cash, together with a land and property portfolio valued in existing use at £20.5 million, based on a valuation commissioned by the Welsh Government¹.
- 3 The portfolio of 18 sites across Wales was transferred to RIFW so that RIFW could dispose of the assets to generate cash proceeds for investment by the Fund in regeneration projects. Translating the value of the land and buildings into cash in a timely manner was crucial to the Fund's success as a regeneration vehicle. In order to draw down the full amount of available EU funding, RIFW needed to sell enough of the land and property assets to have £15.4 million of match-funding cash available and to invest it, along with the £25 million of ERDF funds, before the end of 2015 in those parts of Wales designated by the EU as regeneration areas.
- 4 In December 2010, the Welsh Government appointed two private-sector companies under contracts to manage the day-to-day business and to support and advise the RIFW Board. Lambert Smith Hampton Group Limited (LSH) was appointed as Investment Manager and Amber Infrastructure Limited (Amber) as Fund Manager. Amber joined the LLP as a non-voting Member.
- 5 In March 2012, RIFW sold 15 land and property assets from its portfolio for £21.7 million, payable in three instalments. Two of the 15 sites were subject to 'claw-back' overage clauses entitling RIFW to a share of future profits, subject to certain contractual conditions, if the assets' value increased within a specified period following the sale². The purchaser was a Guernsey-based company, South Wales Land Developments Limited (SWLD)³. The sale was agreed in principle at a meeting of the RIFW Board on 9 June 2011, the precise sale terms were finalised on 31 January 2012 and contracts were exchanged on 18 February 2012. The sale of 14 assets was completed on 2 March 2012 for £15.7 million and for the final site on 1 March 2013 for £6 million, once pre-conditions for the sale of that site had been fulfilled.

¹ Valued as at October 2009 and reconfirmed in March 2010.

² The contractual arrangement whereby the seller is entitled to a proportion of future profits arising from an increase in the value of the asset sold, within a specified period. Selling an asset subject to such a clause can provide some protection to the seller and yield additional returns from a share of any uplift; however, including such a clause generally (though not always) results in the buyer negotiating a lower sale price.

³ SWLD was subsequently registered as a UK Company, in February 2014.

- 6 Since the sale, Monmouthshire County Council has included a site sold by RIFW within its allocation for development in its Local Development Plan and granted planning consent for development. Subsequently, SWLD sold the site to a developer. The overage clauses included in the sale terms agreed between RIFW and SWLD provide for additional sale receipts to be paid to RIFW in these circumstances although the actual sum has not yet been determined. SWLD has also applied for planning consent in relation to the Lisvane site and, if this is granted, then according to the sale contract terms RIFW would receive further receipts based upon a proportion of any resulting increase in value. LSH advised RIFW that their estimate of the total additional payments to RIFW arising from the overage clauses in relation to the two sites could be £10.9 million.

Box 1 – Overall conclusions

Overall, we have concluded that:

Due to flaws in the way RIFW was established, in the selection of assets and also in the sale process itself, neither RIFW nor the Welsh Government are able to demonstrate that value for money was achieved from the portfolio sale transaction.

This is because:

- the RIFW investment concept was innovative and has many merits, but the need to sell property assets was a distraction from RIFW's core investment purpose;
- effective Welsh Government oversight of RIFW's activities was difficult because of ambiguities and governance weaknesses within the arrangements for implementing RIFW;
- due to flaws from the outset, the Welsh Government and RIFW cannot provide public assurance that the land and property portfolio sale achieved value for money; and
- overall, the actions that the Welsh Government and WEFO have taken in response to the developing concerns about RIFW have been appropriate.

- 7 We reached these conclusions for the following main reasons:
- a the Welsh Government's decision to include property assets instead of cash within the Fund, and the consequent need for RIFW to realise proceeds from property sales within a depressed market to match-fund investments against a set timescale, distracted RIFW from its core investment purpose;
 - b the Welsh Government's selection of assets to transfer to RIFW included some assets which had potential for significant uplifts in value and many of the assets were not readily saleable, due to title and other issues that RIFW had to resolve prior to sale;
 - c the RIFW Board approved a business plan to sell the whole portfolio before 2015, but was not advised that the assets offering the greatest development potential could have been retained for future disposal, whilst still meeting investment match-funding requirements;

- d the portfolio sale of the assets by private treaty was opportunistic and was a departure from RIFW's previously approved disposal plan for a phased disposal, including sales on the open market, and therefore the risk of not realising the full value of the assets should have been given greater consideration in the advice provided to the RIFW Board;
 - e the sale process was flawed due to the absence of an up-to-date independent valuation and proper marketing;
 - f there were gaps in information provided to RIFW by the Welsh Government and weaknesses in the quality of professional advice, and so information that was material to the RIFW Board's decisions on disposal of the assets was not clearly presented to them;
 - g the portfolio sale, which took two years, stretched the limited capacity of the RIFW Board to provide effective oversight of the sale process; and
 - h arrangements for accountability to, and oversight by, the Welsh Government were inadequate given RIFW's status as an LLP.
- 8 Overall, in relation to the portfolio sale we found that:
- a An early disposal of RIFW's portfolio had the potential to release cash quickly for RIFW to invest in regeneration projects, during a period of difficult economic conditions in which property values were unstable and future development prospects were uncertain. In this context, the RIFW Board's decision to proceed towards an early disposal was reasonable in principle, based on the advice they received.
 - b The sale agreement did not provide sufficiently for the seller, RIFW, to benefit from future increases in the value of the assets sold. Although overage clauses were used in relation to two of the 15 sites (at Lisvane and Monmouth), seven other sites also offered opportunities for development and hence potentially significant increases in value arising from future changes in their planning status.
 - c If RIFW had not sold the property assets in a single lot (as a portfolio) and had instead adopted alternative approaches to disposals, timed to maximise the sale proceeds from the individual assets, then the total potential returns for the public purse could have significantly exceeded those generated by the portfolio sale, including the likely receipts from the overage clauses that were included in the sale agreement.
- 9 Because the sale was a sale by private treaty, without open marketing, the Auditor General commissioned independent⁴ professional valuation advice from the District Valuer Services of the Valuation Office Agency (the District Valuer). Our conclusions are reinforced by, but are not completely dependent upon, the District Valuer's valuation of £30.9 million⁵ for the property portfolio sold to SWLD,

⁴ The term 'independent' in relation to the District Valuer's valuation report is used to differentiate it from the various valuations commissioned by parties to the sale transaction, without implying that valuations commissioned by the parties were not conducted in an independent manner in accordance with the professional standards of the Royal Institution of Chartered Surveyors (RICS).

⁵ The District Valuer's valuation of the assets is based upon an open sale of the portfolio, supported by proper marketing, between a willing seller and willing buyer, in which both parties acted knowledgeably, prudently and without compulsion.

excluding any future receipts from overage. This valuation, which is higher than other valuations of the portfolio⁶, is predicated on different valuation assumptions and also an alternative approach to disposal that would maximise potential returns for RIFW.

- 10 We acknowledge that RIFW's structure and remit were not designed to facilitate realisation of the maximum potential sale proceeds from its asset portfolio in the short-term. If the Welsh Government had accepted this risk in order to achieve a policy objective to encourage regeneration, then we consider that its acceptance should have been explicitly stated. Furthermore, RIFW's understanding of the assets' value was based upon a notional 'transfer value' set by the Welsh Government below the asset portfolio's market value and which was already known within the property market. Therefore, we consider it unlikely that RIFW could have disposed of the assets to achieve sale proceeds consistent with the District Valuer's market valuation. Even if the District Valuer had concurred with the actual sale price achieved, for these reasons and also those set out in [paragraphs 7 and 8](#), the Auditor General's overall conclusions would remain unchanged.
- 11 Since October 2012, the actions taken by the Welsh Government in handling the concerns about RIFW have been reasonable given that, as set out in [paragraphs 15 to 17](#), both Ministers and officials were constrained in the range of actions that they could take. However, when an Assembly Member tabled an Assembly Question about the asset sale in March 2012, Welsh Government officials did not seek to validate assertions provided to them by Amber and the RIFW Board before providing advice to the Minister.
- 12 The October 2012 decision of the Welsh Government to pause RIFW's operations had an immediate impact on the RIFW Board's ability to transact business, in part because the decision was not publicly communicated until the Ministerial Statement of February 2013. The former RIFW Board members sought to maintain the viability of the Fund's investment pipeline, but were restricted in the actions they could take in managing the pipeline or disposing of the Fund's remaining property assets during the pause.
- 13 The concept of RIFW, which aimed to support regeneration projects in Wales using an investment rather than a grant funding model, was innovative and undoubtedly has many merits. Our recommendations in this Report are directed towards addressing issues that we have identified in the Welsh Government's relationships with arms-length bodies it establishes and are intended to support managed risk-taking and good governance, not to stifle innovation. In a climate of continuing austerity, it is important that the Welsh Government continues to explore new ways of supporting its policy priorities that are sustainable and harness the skills, experience and finance of the private sector.

6 See Appendix 3.

Recommendations

- 14 We make the following recommendations to the Welsh Government and to RIFW. Recommendations **R1** to **R3** are specific to RIFW's circumstances, whereas recommendations **R4** to **R8** are of general application.

Recommendation
<p>R1 In relation to RIFW, the Welsh Government should ensure that arrangements for its future governance, oversight and accountability are robust and clearly understood by all stakeholders.</p>
<p>R2 When making decisions on disposing of the remainder of its asset portfolio RIFW should take account of the findings of this Report in relation to the sale process.</p>
<p>R3 The Welsh Government should investigate whether state aid was provided and, if so, whether it was unlawful; and should discuss with the UK Government the need to refer the portfolio sale transaction to the European Commission as required by the European Commission's Communication on State aid elements in sales of land and buildings by public authorities.</p>
<p>R4 The Welsh Government should clearly define the functions of arms-length bodies⁷ and ensure that their boards:</p> <ul style="list-style-type: none"> • understand their functions and have appropriate capability and capacity to discharge them; • are clear about the time commitment for board members and that remuneration levels are appropriate; • are provided with effective induction training covering the respective needs of: <ul style="list-style-type: none"> – Welsh Government officials appointed to boards; and – non-executive and externally appointed board members.
<p>R5 The Welsh Government should exercise proper oversight of its arms-length bodies to ensure that they each demonstrate good governance and remain focused on their core activities. This should include an appropriate level of oversight by Welsh Government Corporate Governance Committees.</p>
<p>R6 The Welsh Government should ensure that transfers of the responsibility for overseeing arms-length bodies between its departments are managed effectively.</p>
<p>R7 The Welsh Government should review the effectiveness of its internal quality-assurance arrangements for providing Welsh Ministers with draft responses to Assembly Questions.</p>
<p>R8 When engaging external consultancy services, the Welsh Government should make clear at the outset its expectations concerning the agreement of consultants' reports with relevant third parties for factual accuracy, completeness and balance.</p>

⁷ For the purposes of this report the use of the term 'arms-length' is intended to indicate the commercial independence of RIFW; reflecting the need to make investment decisions without day-to-day influence from the Welsh Government, ensuring that the extension of a loan does not constitute state aid. It is not intended to include Assembly Government Sponsored Bodies or similar, which enjoy a level of independent governance but do not operate on a commercial basis.

- 15 From the outset of this study, the Auditor General decided to liaise with South Wales Police because of audit risk factors in relation to the property transaction, specifically:
- a the size of the sale, which had been conducted as a sale by private treaty, rather than an open-market transaction;
 - b some of the public assets included within the sale transaction offered potential for development and significant increases in resale value;
 - c a meeting of RIFW Board members to discuss the offer to buy the portfolio was not minuted and the RIFW Board meeting at which the Board agreed in principle to accept the offer was inquorate;
 - d certain parties involved in the execution of the sale transaction had relationships with the buyer and the seller that could potentially have given rise to conflicts of interest;
 - e the purchaser was a company created specifically for the purposes of the transaction, which was registered offshore;
 - f the purchaser's funds originated offshore; and
 - g the arms-length status of RIFW served potentially to limit the extent of political and public scrutiny of its activities.
- 16 These factors are indicators of audit risk and are not in themselves evidence of improper conduct or criminality. Therefore, the decision to liaise with South Wales Police was made without prejudice to any individuals or organisations. Following initial consideration, South Wales Police decided to engage with the Serious Fraud Office. The Auditor General was also aware that, should any issues which may emerge during his study give rise to a Police or Serious Fraud Office investigation, it was imperative to ensure that the conduct of his study, including the collection and retention of audit evidence, would not compromise any such investigation.
- 17 As at the publication date of this report, the Auditor General has been informed by the Serious Fraud Office, that having taken time and given careful consideration to the information available pertaining to RIFW, they have concluded that this is not a matter which falls within their remit for investigation. Should further information come to the attention of the Serious Fraud Office or South Wales Police, the matter may be reviewed.
- 18 We are satisfied that LSH, Amber and the former RIFW Board members engaged constructively with the Auditor General and his study team in the course of his study. LSH, Amber and the former RIFW Board members responded to requests for information, met the study team when required and fully co-operated with the conduct of the review.

- 19 This report covers events to 30 June 2014 in detail and is based upon information received and study fieldwork up to that date. After this date only significant events are identified. Certain information in relation to assets included within the sale and in respect of assets retained by RIFW is commercially sensitive and has not been included in this report because its publication could potentially prejudice future returns to the public purse.
- 20 The methodology used by the study team is described in [Appendix 1](#), and a detailed timeline of key events is in [Appendix 2](#).

Exhibit 1: Key dates summary *

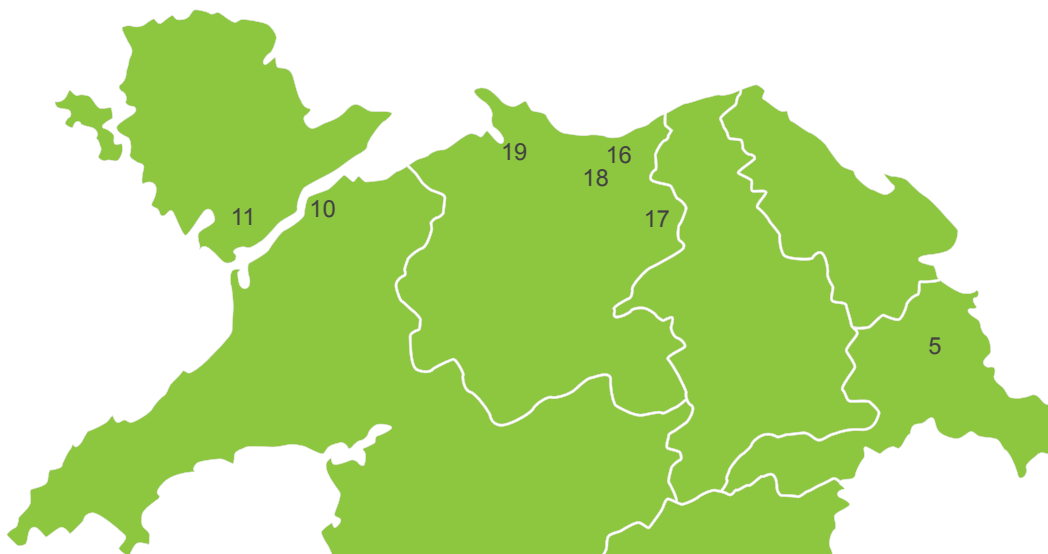
* A more detailed timeline is provided in [Appendix 2](#)

Date	Event
March 2010	£55 million investment Fund established, comprising £25 million EU ERDF (to be invested by the end of 2015) plus £9.4 million cash and 18 property assets transferred at a notional value of £20,627,000 from the Welsh Government. ERDF match-funding requirement is £15.4 million. An adjusted figure, deducting £100,000 of land not transferred is £20,527,000.
December 2010	Fund manager (Amber) and investment manager (LSH) formally appointed, following competitive tender, to manage RIFW's day-to-day business.
March 2011	Initial cash offer for entire portfolio (sites listed included assets not transferred to RIFW) received from GST Investments for £23.0 million and reported to the RIFW Board. RIFW Board approves RIFW First Business Plan, including preferred option for a phased disposal of all assets by end 2014 to yield a 'realisation value' of £24.935 million.
June 2011	Sale of portfolio of 18 land and property assets to GST Investments for £22.5 million payable in instalments, with overage clauses on two sites, is agreed in principle by RIFW Board.
February 2012	Sale contracts exchanged for portfolio of 15 assets for a total of £21.7 million, including overage agreements for two sites that provide for RIFW to share in any future value uplift. A deposit of £2.17 million is paid.
March 2012	Portfolio sale of 14 assets completed for £15.7 million, plus overage on two sites at Lisvane and Monmouth. Sale of 15th asset, at Brackla, for £6 million, is conditional (completed in March 2013). Remaining payment to be made in three interest-free instalments over two years. An Assembly Member sends an email to the Auditor General expressing initial concerns about the asset portfolio sale transaction.

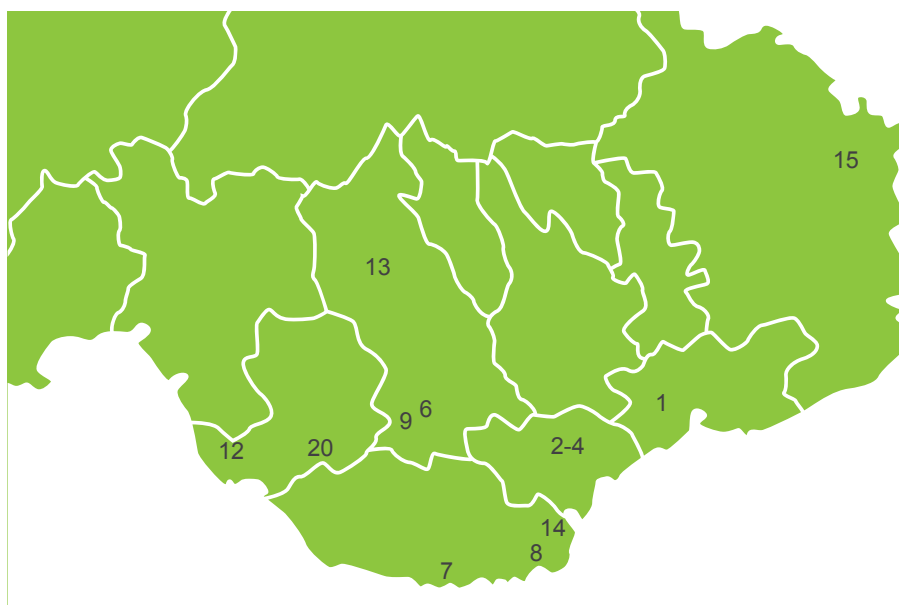
Date	Event
October 2012	The Auditor General announces a value-for-money study of RIFW. The Welsh Government suspends RIFW's activities.
February 2013	The Welsh Government publicly announces the pause to RIFW's activities and also announces two independent reviews, of governance arrangements and of professional advice.
September 2013	SWLD submits an outline planning application for 1,200 new homes on the Lisvane site, the 'Churchlands development'. Planning consent would trigger an overage payment to RIFW based upon a proportion of any increase in the site's value.
October 2013	The Welsh Government's Housing and Regeneration Department takes direct control of RIFW in order to allow the Fund's activities to be brought back under direct Ministerial control. The RIFW Board members resign and are replaced by two Welsh Government officials as an interim measure.
January 2015	City of Cardiff Council refuses to grant planning consent for the 'Churchlands development' on the Lisvane site. SWLD appeals against the decision.
April 2015	Onward sale by SWLD of Monmouth site which was included in the Local Development Plan adopted by Monmouthshire County Council in February 2014 and received planning consent for mixed residential and employment development in December 2014. Under the terms of the overage clauses in the sale contract agreed between RIFW and SWLD these events will trigger additional payments to RIFW based upon a proportion of any increase in the site's value.

Exhibit 2 - The RIFW asset portfolio

North Wales



South Wales



1 Imperial Park, Newport	12 Ty Draw Farm, Pyle
2-4 Three freehold farms, Lisvane, Cardiff	13 Mayhew Foods site, Aberdare
5 Wrexham Industrial Estate	14 Anchor Way, Penarth
6 Llantrisant Business Park	15 Wonastow Road, Monmouth
7 Upper House Farm, Rhoose	16 Towyn Way East, Towyn
8 Cogan Hall Farm, Penarth	17 Pen y Bryn, St Asaph
9 Garth Park, Talbot Green	18 St Georges Road, Abergele
10 Goetra Uchaf Farm, Bangor	19 Waenfynydd Farm, Llandundo Junction
11 Ty Mawr, Llanfairpwllgwyll, Anglesey	20 Brackla Industrial Estate, Bridgend

Part 1

The RIFW investment concept was innovative and has many merits, but the need to sell property assets was a distraction from RIFW's core investment purpose



Part 1 - The RIFW investment concept was innovative and has many merits, but the need to sell property assets was a distraction from RIFW's core investment purpose

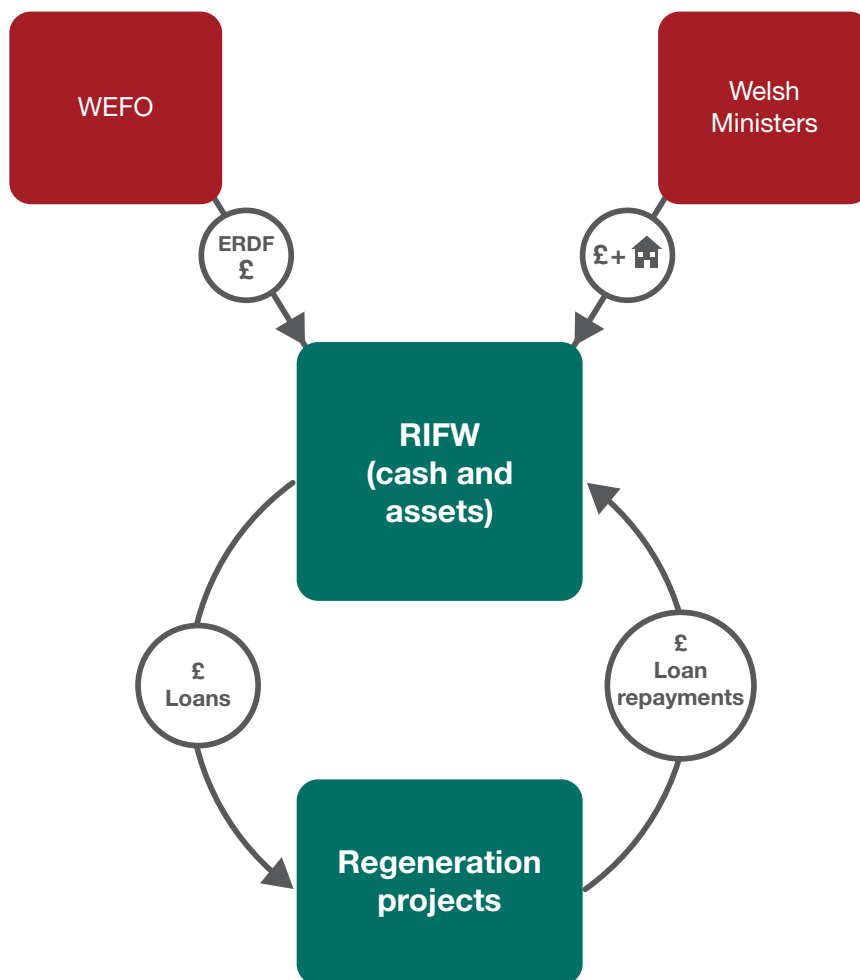
The Welsh Government's overall purpose for RIFW was innovative and was clear at the outset

- 1.1 In December 2009, the Welsh Government established the Regeneration Investment Fund for Wales LLP (RIFW) as the urban development fund for Wales. Effectively wholly owned by the Welsh Government, RIFW would access European Regional Development Fund (ERDF) funding provided under the European Commission's JESSICA (Joint European Support for Sustainable Investment in City Areas) initiative. One of four JESSICA programmes within the UK, the investment-fund model adopted by RIFW for accessing JESSICA funding is unique amongst EU member states.
- 1.2 The RIFW concept departed from the more traditional model, which simply provided grants to regeneration schemes. It was a two-phase investment-based model, which, by issuing repayable loans rather than grants, was intended to become self-sustaining.
 - a In the first phase, RIFW would use JESSICA funds from the Welsh European Funding Office (WEFO) to provide repayable loans for development projects in the Welsh regeneration areas designated by the EU as being eligible for ERDF funding. Funding provided by the Welsh Government in cash or released from property sales, above that which was required for match-funding, could be used outside EU designated areas.
 - b In the second phase, RIFW would recycle the repaid loans (plus interest) and invest these through loan finance to a wider range of regeneration projects than is allowable under EU rules, including to projects in locations outside the EU designated areas. In phase two, RIFW could also seek to expand the fund by seeking additional finance from private investment partners, thereby reducing reliance upon public funds in the longer term and increasing the overall size of the fund from £55 million to £110 million.
- 1.3 Although RIFW was conceived shortly before the 2008 global financial crisis and subsequent credit-crunch, and therefore was not developed to address those specific circumstances, financial conditions at the time made it more difficult for regeneration projects to access private sector sources of funding. The RIFW concept therefore offered opportunities to fill an important gap in the financial market, whilst also meeting Welsh Government policy priorities for economic, environmental and social regeneration in a sustainable way. The Members Agreement, used to establish the Fund, envisaged that RIFW would have an initial life of 12 years but that this could be extended by Welsh Ministers.

The Welsh Government identified risks in relation to match-funding and making investments, but the focus on securing EU funding meant that the risk of failing to maximise potential returns from asset sales was not handled effectively

- 1.4 The process under which the RIFW model was conceived and approved began in early 2008, when the (then) Deputy Minister for Regeneration approved the project in principle. In September 2008, the European Investment Bank commissioned a preliminary study to examine the investment concept as a way of establishing a JESSICA fund for Wales. The preliminary study report identified the possibility that land and property assets owned by the Welsh Government could be used in establishing the fund.

Exhibit 3 - The conceptual model for RIFW in phase one of the Fund



- 1.5 Access to private-sector expertise was central to the RIFW concept. This expertise was needed in order to assess the investment potential of regeneration projects applying for funding and to ensure that subsequent RIFW investment decisions were commercially based. The process for recruiting suitable fund and investment managers began in August 2009. In December 2009, RIFW was registered as an LLP at Companies House.
- 1.6 The EU required that the Welsh Government should provide matched ERDF funding to regeneration projects within the areas of Wales designated by the EU. In order to draw down the full £25 million of ERDF funds allocated to Wales under the JESSICA scheme, RIFW needed to ensure it had sufficient cash, £15.4 million, for match-funding during the lifetime of the JESSICA scheme, to December 2015. RIFW also needed sufficient funds to meet its operational expenses. The Welsh Government decided to commit £30 million, which was more than was required for match-funding, thereby establishing RIFW as a fund with £55 million of assets for investment in regeneration projects across the whole of Wales. Because the Welsh Government departmental budgets lacked the flexibility to provide all of the £30 million in cash, instead land and property assets were transferred to RIFW, as shown in [Exhibit 4](#). The intention, as set out in the Fund Manager’s agreement, was that these assets could be liquidated as necessary, to meet the investment funding needs of regeneration projects supported by RIFW.

Exhibit 4 - The RIFW Investment Fund

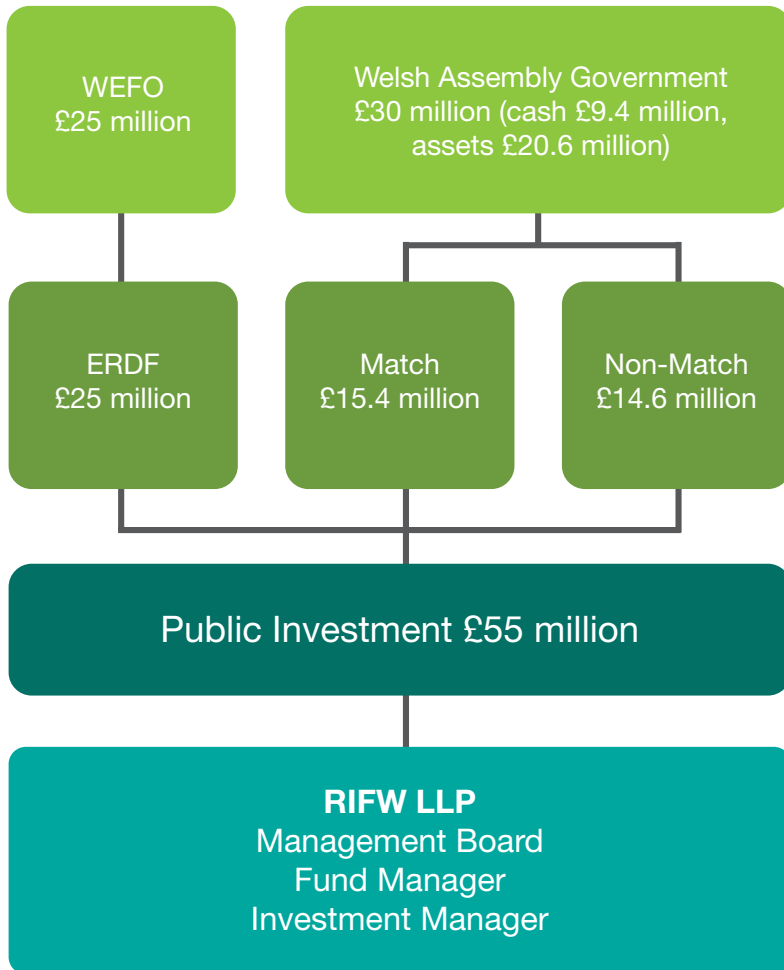
Initial composition of the RIFW Investment Fund	
Funding source	Amount (£ million)
European Commission: ERDF – JESSICA	25.0
Welsh Government: Property asset portfolio	20.6
Welsh Government: Cash	9.4
Total Fund value	55.0

- 1.7 In March 2010, a JESSICA Business Plan proposing this model was prepared for the Welsh Government by independent consultants and submitted to the Welsh European Funding Office (WEFO). The (then) Deputy First Minister gave approval for the Welsh Government to provide £9.373 million in cash along with £20.627 million in land and property assets⁸, contributing £30 million in cash and property to the Fund. Of this, £15.4 million was required for match-funding and £14.6 million was above that which was required for match-funding⁹. The initial composition of the RIFW investment fund is shown in [Exhibit 5](#).

8 In March 2010, King Sturge valued the assets at between £20.65 million and £26.40 million (including £100,000 of land which was not actually transferred). The lower value reflected existing use whereas the higher value included 'hope value' for assets identified as having potential for value uplift resulting from change of use and reflected the market value of those assets.

9 The EU funding scheme did not require match-funding to be pound for pound.

Exhibit 5 - RIFW Financial Structure and funding sources during Phase 1 of the Fund



1.8 The Welsh Government identified several key risks when establishing RIFW¹⁰, most notably the need to ensure that progress with making investments would be sufficient to enable the full £25 million of ERDF funding to be spent by the end of 2015. If investment activity were insufficient by this point, then any unspent ERDF grant would need to be returned to the EU. The Welsh Government also recognised the risk that the land and property portfolio might not be converted into cash in a timely enough way to facilitate match-funding and the drawdown of ERDF grant; or indeed that the sale of the assets might not generate enough cash to provide the £15.4 million required for match-funding. The other major risk areas which the Welsh Government focused upon were:

10 Documented in the Welsh Government's **JESSICA Business Plan for ERDF funding**, March 2010.

- a ensuring the eligibility of regeneration projects for investment of EU funds; and
- b ensuring compliance with EU rules on state aid when making investments in regeneration schemes.

This narrow focus of business planning on ERDF grant and match-funding issues did not sufficiently recognise the broader purpose of the Fund and did not consider the wider range of risks that RIFW faced.

- 1.9 The need for RIFW to realise sufficient proceeds from property sales to fund its investment operations represented a significant distraction from its core purpose, to invest in regeneration schemes. Importantly, the risk that the value of the assets may not be optimised was identified but the attention on achieving what was needed to secure the ERDF funding diminished the focus necessary to manage this risk effectively. If, in order to achieve a policy objective to encourage regeneration, the Welsh Government had been prepared to accept this risk then we consider that acceptance should have been explicitly stated in the Welsh Government's JESSICA Business Plan.

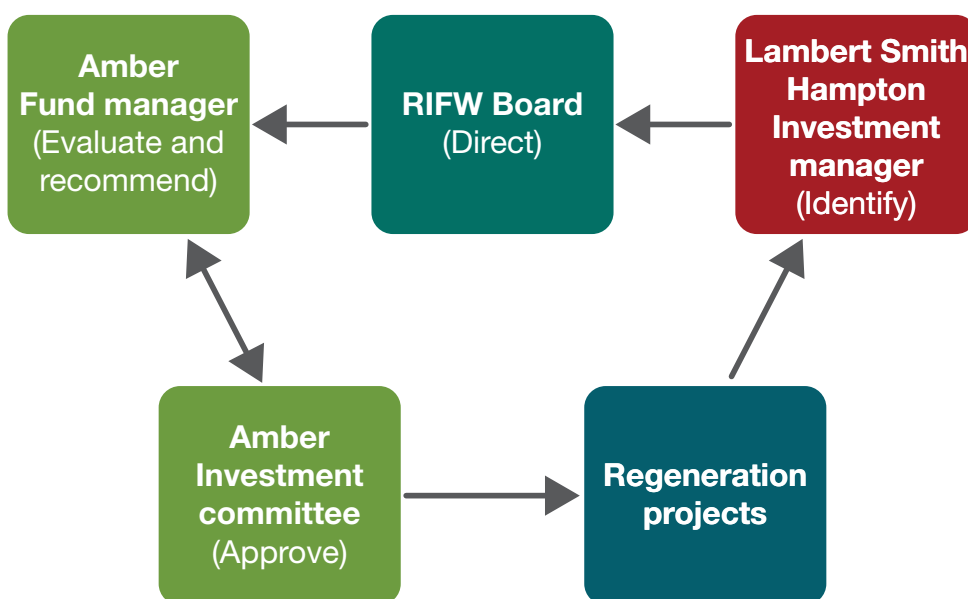
Progress with RIFW's investment business was slower than both the Welsh Government and WEFO had expected

Expectations that the first investments would be made in early 2011 underestimated the time it would take for RIFW to establish the Fund and evaluate potential investments against WEFO's requirements

- 1.10 During 2009 and 2010 Welsh Government officials prepared a list of known potential projects, intended to provide the RIFW investment and fund managers with an 'investment-ready' series of potential projects. However, following their appointments, the investment and fund managers identified upon scrutiny through their diligence processes that many of the projects were relatively immature and were not as 'investment-ready' as the Welsh Government had anticipated.
- 1.11 During the evaluation and due diligence process the investment and fund managers considered a range of criteria which included financial viability, compliance with ERDF requirements, and inclusion in an Integrated Plan for Sustainable Urban Development (IPSUD). Many of the inherited potential projects did not meet at least one of these criteria. The managers had to request additional information on these projects, and require further action. For example, private-sector applications for RIFW investment funding are capped at a maximum loan of £10 million, and so applicants requesting in excess of this amount were required to seek additional funding from other sources. During this process, the investment and fund managers worked with applicants to help them develop more robust project proposals that could proceed to the next stage.

- 1.12 The criteria for investment set by WEFO originally included a restriction that the total value of retail economic activity funded through ERDF eligible expenditure and match-funding in any scheme must be less than 50 per cent of the total expenditure. By early 2012, a number of scheme sponsors had approached RIFW with schemes that had a greater than 50 per cent retail component, and so were deemed ineligible. However, Amber had reported to RIFW that these schemes demonstrated good regeneration benefits and a strong IPSUD.
- 1.13 From February 2012 onwards, WEFO permitted scheme proposals to exceed the 50 per cent limit on the retail component. The two conditions for this were clear evidence that:
- a the investment was central to the relevant IPSUD; and
 - b the relevant established town centre was the most appropriate location for retailing, leisure and other complementary functions.
- 1.14 The economic situation undoubtedly limited the level of applications because some potential applicants were nervous about proceeding with projects. Some investors were also more used to the provision of grant funding for regeneration projects and did not initially appear to think of RIFW as a funding option. However, other funding organisations' reluctance to invest in new projects at this time drew applicants to consider RIFW and the funding arrangements it offered. In order to raise RIFW's profile and increase awareness of its investment offers, road shows were undertaken across Wales, targeting public and private bodies separately.

Exhibit 6 - RIFW's process for investment project decisions



- 1.15 The quarterly reports prepared by Amber for the Board indicate that by early 2013 the stream of potential projects had strengthened and an increasing number of potential projects had been evaluated. The RIFW progress report to WEFO for the period ending 30 April 2013 documented that there were 62 projects at various stages of development, including:
- a 14 projects discontinued as they did not meet the criteria;
 - b 38 projects in the early stages of evaluation;
 - c nine projects at the 'expression of interest' stage, or further along the evaluation and due diligence process; and
 - d one project, submitted by Neath Port Talbot County Borough Council (Neath Port Talbot CBC), with approved RIFW funding in place.
- 1.16 In its role as Fund Manager, Amber applied robust evaluative and financial due diligence procedures to applications from potential projects for investment funding. Despite pressure from the need for RIFW to commit funds to regeneration projects by December 2015 in order to draw down the full amount of its available ERDF funding, our review of a sample of applications found that Amber's decisions in respect of approval or rejection on behalf of the RIFW Board were soundly based.

Box 2 – RIFW’s first investment was made in October 2012, in a project to redevelop Neath town centre

The first investment made by the Fund was a £13 million loan to Neath Port Talbot CBC for a project to redevelop Neath town centre. This investment became eligible under the revised retail criteria, and WEFO confirmed compliance in August 2012 during the due diligence process. The investment was approved by RIFW in October 2012 and the first monies were drawn down in November 2012 (this investment was the only one made by the Fund prior to the suspension of its activities by the Minister, later in October 2012).

The RIFW investment provided funding for the first phase of the redevelopment project. This comprised the design and build of a new multi-storey car park and working up full planning for construction of 55,700 square feet of retail and commercial space, together with the enabling works to prepare the site for further development. These works included relocating the Magistrates Court and public infrastructure works.

The second phase comprises development of 100,000 square feet of retail and commercial space, together with further public infrastructure. This work is planned to be undertaken from December 2014 to March 2016. The total project cost was estimated at £26.225 million, with the remainder of the costs being funded from grants and Neath Port Talbot CBC’s own resources. The Project was expected to deliver 32 per cent of the EU job creation target for the Fund.

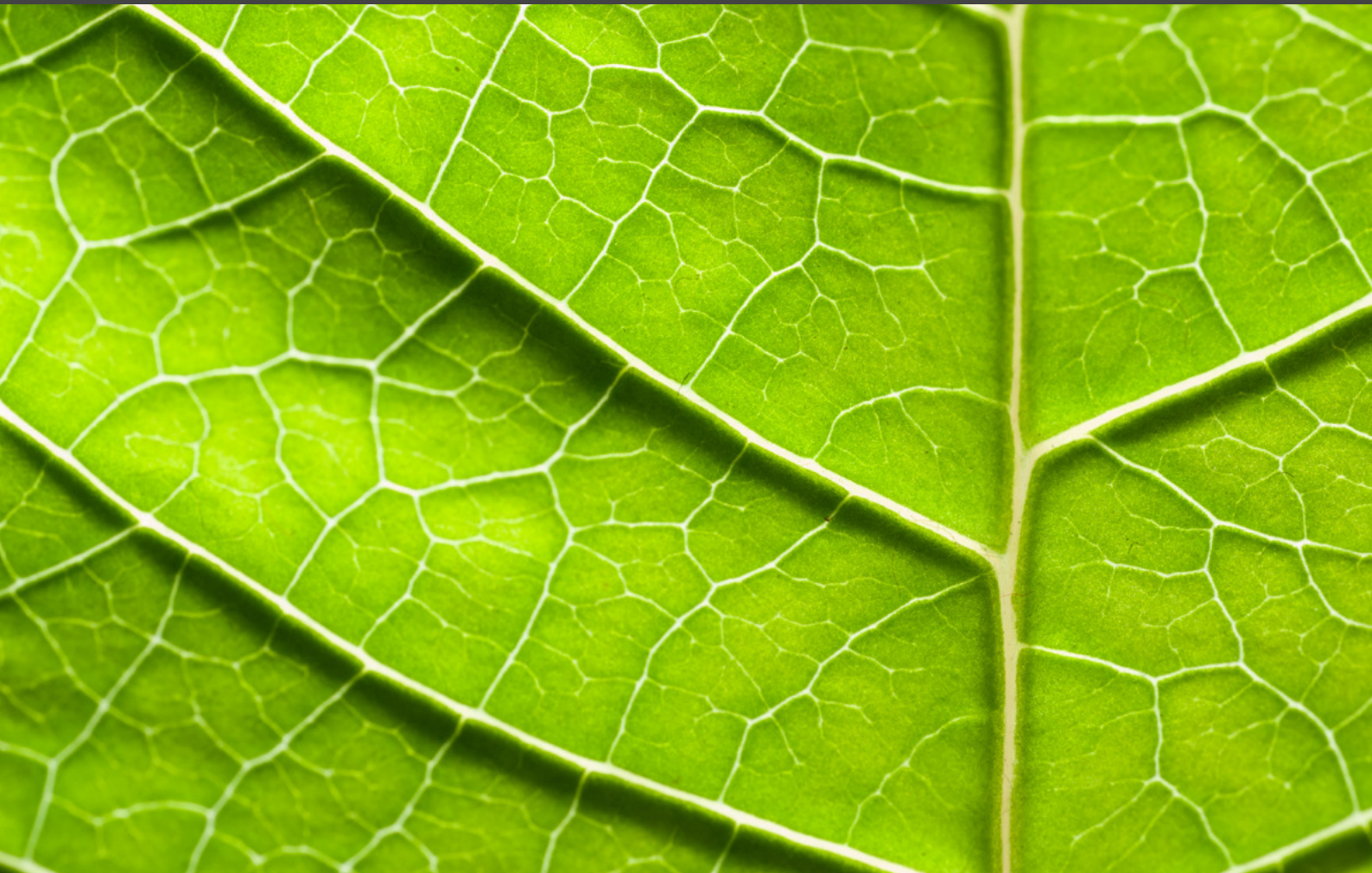
Although the project was still under development at the time of the RIFW investment, the evaluation and due diligence undertaken by Amber and LSH identified that it met the investment criteria for a public-sector borrower; fulfilled the ERDF criteria; and complied with IPSUD requirements. On behalf of the Fund, Amber therefore approved the availability of funding to Neath Port Talbot CBC, subject to specified conditions.

Since the RIFW investment was made in late 2012, Neath Port Talbot CBC has completed the project’s development planning stage and has procured a contractor to commence the enabling works. The timetable has slipped from that which was originally agreed, but the importance of this slippage has reduced now that the project is no longer tied into the ERDF requirement to complete investment by December 2015.¹¹ Welsh Government officials informed us that they are continuing to monitor drawdown of the funds and project progress, to ensure the RIFW funds are used as agreed.

¹¹ See Section 4, paragraph 4.18.

Part 2

Effective Welsh Government oversight of RIFW's activities was difficult because of ambiguities and governance weaknesses within the arrangements for implementing RIFW



Part 2 - Effective Welsh Government oversight of RIFW's activities was difficult because of ambiguities and governance weaknesses within the arrangements for implementing RIFW

In establishing RIFW's governance arrangements, the Welsh Government failed to make explicit the oversight mechanism for RIFW as an arm's-length body¹²

- 2.1 There were a range of legal and practical reasons for RIFW's governance arrangements:
- a EU funding rules for the JESSICA programme required that RIFW should sit at arm's-length from the Welsh Government (and therefore could not have its own Accounting Officer);
 - b RIFW investment decisions needed to be commercially based; and
 - c demonstrable managerial independence from political influence would be vital, particularly when seeking potential private-sector investment partners during the planned second phase of RIFW's existence.
- 2.2 To provide a balance between independence and oversight, the Welsh Government established RIFW as an LLP, effectively wholly owned by the Welsh Government¹³. Collectively, the Welsh Ministers are members of the LLP, alongside Amber Infrastructure Limited. The Welsh Government obtained external legal advice on the LLP model for RIFW and the governance arrangements that support it, to ensure compliance with EU rules.

Box 3 – The RIFW Limited Liability Partnership (LLP)

The RIFW LLP functions under the terms of an LLP Members' Agreement, initially signed by the Welsh Government in March 2010, then amended and formally executed in December 2010, which sets out the rules governing how the LLP operates. The Members' Agreement:

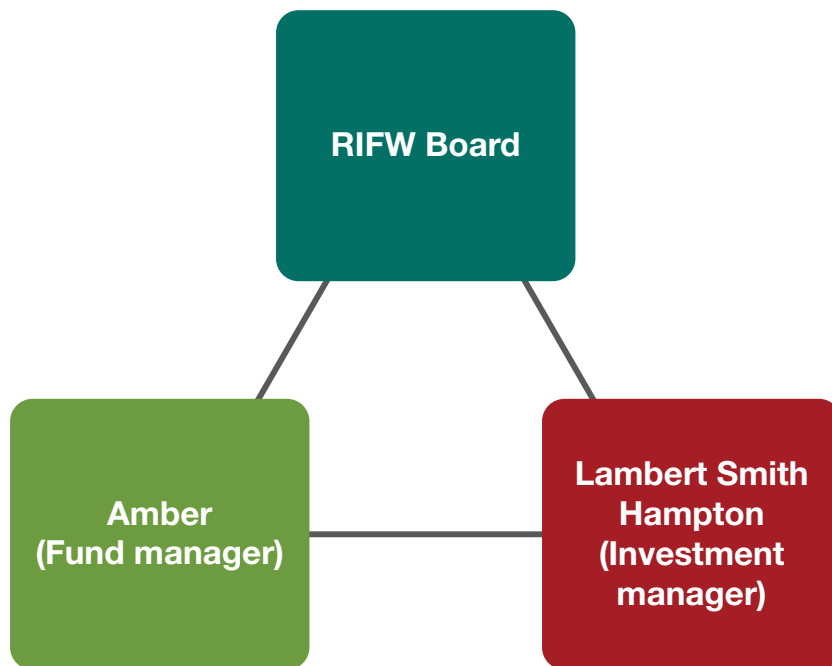
- sets out RIFW's purpose and objectives;
- defines the roles of the LLP partners (the Welsh Ministers and Amber Infrastructure Ltd);
- establishes a Management Board for RIFW;
- recognises the fund manager's role, set out in the Fund Manager's Agreement;
- recognises delegation of investment responsibility to an investment manager under an Investment Manager's Agreement; and
- requires RIFW to produce a Business Plan and update it annually.

¹² For the purposes of this report the use of the term 'arms-length' is intended to indicate RIFW's commercial independence; reflecting the need to make investment decisions without day-to-day influence from the Welsh Government, ensuring that the extension of a loan does not constitute state aid. It is not intended to include Assembly Government Sponsored Bodies or similar, which enjoy a level of independent governance but do not operate on a commercial basis.

¹³ An LLP differs from a limited company, notably in respect of its legal status, its members' responsibilities (who are not company directors) and its taxation treatment.

2.3 RIFW is administered through private-sector fund and investment managers, independent of Welsh Government, appointed via a competitive tendering process. These managers are responsible for the day-to-day operation of the Fund and report to the RIFW Board. They are able to conduct their business without recourse to the Board as long as their actions are in line with the Business Plan approved by the RIFW Board. The fund manager, Amber Infrastructure Ltd (Amber), is also a member of the LLP alongside the Welsh Ministers. The investment manager, Lambert Smith Hampton (LSH), attended RIFW Board meetings as a non-voting advisor.

Exhibit 7 - RIFW's business management structure



- 2.4 The RIFW Board's composition included two Welsh Government officials as voting members (one of whom is the Chairman). Board meetings were also attended by a Welsh Government official as an observer, who was copied into key documentation. As the LLP's executive functions are undertaken by Amber, RIFW itself has no Chief Executive. Furthermore, RIFW did not have its own Accounting Officer. Therefore, the accountability chain for reporting via the relevant departmental Additional Accounting Officer to the Permanent Secretary (as Principal Accounting Officer) should have been more clearly defined.
- 2.5 RIFW falls within the Welsh Government's accounting boundary and its accounts are consolidated within those of the Welsh Government itself. RIFW therefore was within the remit of the Welsh Government's Corporate Governance Committees, which scrutinise the Welsh Government's activities and seek assurances in relation to the effective operation of governance arrangements. However, RIFW did not feature on the agenda of any of the Corporate Governance Committees until the autumn of 2012, following the Auditor General's announcement of his intention to conduct a full value-for-money study.
- 2.6 The Welsh Government has clear and well-established guidance in place for its relationships with its sponsored bodies, including explicit annual targets and robust monitoring and reporting arrangements. However, no similar guidance has been established by the Welsh Government for its arms-length bodies. An independent review of RIFW's governance arrangements commissioned in 2013 by the Welsh Government¹⁴, identified a lack of clarity in the arrangements for oversight of RIFW's activities, particularly in relation to reporting RIFW's activities to Welsh Ministers. The Review also highlighted some weaknesses and inconsistencies in the Welsh Government's governance arrangements for arms-length bodies and made recommendations for improvements in order to clarify reporting arrangements and strengthen accountability to the Welsh Government.
- 2.7 Under the terms of its funding agreement with WEFO¹⁵, RIFW is required to submit quarterly reports. These reports include:
- a financial information;
 - b a commentary on progress with selecting investment schemes, committing and spending the ERDF¹⁶ and match-funds; and
 - c a forecast of the Fund's delivery profile.

RIFW provided reports to WEFO which had been approved by the Board¹⁷. However, in line with WEFO's responsibilities, its own monitoring of RIFW naturally focused upon the Fund's investment activities and utilisation of the ERDF JESSICA¹⁸ funds, rather than the management and realisation of the Fund's asset portfolio.

¹⁴ **Regeneration Investment Fund for Wales, Governance Arrangements – Internal Review**; Gilbert Lloyd, April 2013 (the Lloyd Report). See also paragraphs 2.28 to 2.32.

¹⁵ Welsh European Funding Office

¹⁶ European Regional Development Fund

¹⁷ Copies of these reports were also provided to the Welsh Government.

¹⁸ Joint European Support for Sustainable Investment in City Areas initiative

RIFW Board members' legal responsibilities were insufficiently aligned with the Welsh Government's expectations of their collective accountability to Welsh Ministers

2.8 Although RIFW's core purpose was clear from the outset, its status as an LLP was novel and it was important that any ambiguity should be addressed through clear guidance specific to similar organisations. No such Welsh Government guidance was in place. There were sound policy and practical reasons for ensuring that RIFW operated on a quasi-commercial basis, without direct political influence, which enabled it to access JESSICA funding. Officials' participation on the Board, the Welsh Government observer's presence at Board meetings and the mechanism of having Welsh Ministers as the sole voting member of the LLP were the intended means by which public accountability should have been assured. In adopting the LLP model, the Welsh Government anticipated that the Board members would represent the interests of Welsh Ministers. Importantly, however, the legal responsibility of all five Board members (including those who were Welsh Government officials) was to act in the interests of the RIFW LLP itself, even if these were not entirely aligned with Welsh Ministers' interests. This inherent tension did not exist for the Welsh Government observer, whose role was entirely focused on protecting Welsh Ministers' interests.

Inconsistency in the operation of the Welsh Government's 'observer' role on the RIFW Board significantly compromised the role's effectiveness

- 2.9 During the period between receiving the initial offer for the portfolio from GST Investments in February 2011 and the Board's acceptance in June 2011 of that offer in principle, the Welsh Government observer attended Board meetings and saw and expressed no concerns on draft Board papers in relation to the proposed sale (although he was not present at the June 2011 meeting). In addition, Amber sought the advice and agreement of the observer when framing their draft recommendations to the Board and in relation to handling a Board member's potential conflict of interest (see paragraphs 3.105 to 3.111). This degree of active involvement by the observer in the conduct of RIFW's business potentially jeopardised the arms-length status of RIFW and also may have created the impression of tacit Welsh Government approval for the terms of the sale in the minds of the RIFW Board members and their advisors.
- 2.10 In contrast, robust oversight of RIFW's activities between July 2011 and January 2012 was substantially hindered by changes in officials and reorganisation of departmental responsibilities within the Welsh Government in the months following the May 2011 National Assembly election. RIFW had been established and was originally overseen by the then Department for Economy and Transport (now the Department for the Economy, Science and Transport). However, in August 2011, responsibility at official level for the regeneration portfolio transferred to the Sustainable Futures Department. When RIFW was established, the Welsh Government deliberately appointed an official from a department other than the

sponsoring department as Board Chairman. However, when the responsibility for RIFW transferred between the two departments, RIFW moved to that official's own department and, as a consequence, this mechanism for ensuring a degree of independent challenge and scrutiny was lost.

- 2.11 The change of departmental 'owner' within the Welsh Government also meant that many of the officials who had been closely involved with RIFW's creation, and who were highly knowledgeable about its purpose and structure, were no longer directly responsible for its oversight. Furthermore, the arrangements for handing over responsibilities within the Welsh Government did not ensure that information about RIFW's purpose, structure and risks was clearly communicated between senior officials of the two departments involved in the transfer. Whilst the Welsh Government observer is expected to attend RIFW Board meetings and RIFW Audit and Risk Committee meetings, the departmental restructure resulted in a lack of continuity in the observer role between September 2011 and January 2012¹⁹. During this period, detailed negotiations between RIFW and the purchaser resulted in substantial changes to the proposed terms of sale (see paragraphs 3.92 to 3.100).

There were administrative flaws in the processes for appointing Board members, and the Board was not well placed to manage conflicts of interest and to properly scrutinise aspects of RIFW's work

Important aspects of Board members' roles and responsibilities were not clearly communicated to them and differences between the employment status of Welsh Government officials and independent members of the Board were not well managed

- 2.12 The RIFW Board first met in March 2010 as a Shadow Board but did not achieve its planned composition, which included public appointees, until January 2011. The five voting members of the Board²⁰, appointed by Welsh Ministers comprised:
- a two Welsh Government officials, both at deputy director level²¹ (one of whom chaired the Board);
 - b a Welsh Local Government Association (WLGA) representative; and
 - c two other external members appointed following an advertised public appointments process.

¹⁹ This hiatus in the Welsh Government's observer attendance occurred after the RIFW Board's June 2011 decision to accept in principle the offer for the portfolio, but before the sale contracts were exchanged, in February 2012. Five Board meetings took place in this six-month period.

²⁰ The individuals appointed were as follows: Mr Patrick Lewis (Welsh Government) Chair from March 2010, resigned from the Board in July 2011; Mr Ceri Breeze (Welsh Government), Board member from March 2010, appointed Chair from October 2011 (substituted as Chair from May 2011); Councillor Christopher Holley (City and County of Swansea and WLGA Representative) from November 2010; Mr Jonathan Geen (Acuity Solicitors) and Mr Richard Anning (Sydney and London Properties) from December 2010. Richard Harris (Welsh Government) from July 2012 to June 2013, when he resigned because his responsibilities within the Welsh Government changed. Board members received no remuneration other than expenses. All of the remaining Board members resigned in October 2013, see paragraph 4.16.

²¹ The two Welsh Government officials on the Board were at Deputy Director level until July 2011. From July 2012 to June 2013, one was at Deputy Director level and the other was at Head of Branch level.

- 2.13 The Welsh Ministers appointed two Welsh Government officials as Board members, to represent their interests. However, under the LLP model adopted for RIFW, the legal responsibility of all five Board members (including those who were Welsh Government officials) was to act in RIFW LLP's interests, even if these interests were not entirely aligned with those of Welsh Ministers. During the course of our study, the Welsh Government commissioned an independent internal review of RIFW's governance arrangements²². This review identified that the two Welsh Government Board members had not received appointment letters setting out their roles and responsibilities as the RIFW Chair and as a Board member respectively.
- 2.14 In November 2010, the Deputy Minister for Regeneration and Housing invited Councillor Chris Holley of the City and County of Swansea Council to join the RIFW Board as the Welsh Local Government Association (WLGA) representative. Councillor Holley received an appointment letter and supporting information which set out:
- a RIFW's role and the Board members' responsibilities;
 - b expectations in relation to Board members' conduct, managing conflicts of interest and restrictions in relation to political activities;
 - c the duration of the appointment, which was for 10 years, with effect from 30 September 2010; and
 - d the anticipated time commitment of four days per year.
- 2.15 The section of the appointment information sent to Councillor Holley dealing with political activity states that he is 'not expected to occupy paid party political posts or hold particularly sensitive or high roles in a political party'. Councillor Holley is the Liberal Democrat Group Leader of the City and County of Swansea Council. Councillor Holley was invited to join the RIFW Board as WLGA representative because he was at that time the WLGA lead for regeneration (Councillor Holley no longer holds this WLGA role). The Review conducted by Gilbert Lloyd identified the need for the Welsh Government to address weaknesses in the paperwork relating to Councillor Holley's appointment.
- 2.16 In December 2010, two further external members were appointed by the Welsh Ministers to the RIFW Board following an advertised public appointment process. These were Mr Jonathan Geen, a solicitor specialising in commercial property; and Mr Richard Anning, a Chartered Surveyor and commercial-property specialist. Together these two members brought to the Board extensive personal expertise in law and property development that would support RIFW's investment activities. Their appointment letters from the Welsh Government both stated that their appointments would run from 1 January 2010 to 31 December 2014, renewable for a maximum of 12 years. However, the accompanying information instead quoted an appointment term of 10 years dating from the end of September 2010. The anticipated time commitment for the two external members was also four days per annum. None of the Board member positions were remunerated, although reasonable expenses would be reimbursed.

²² The Lloyd Report.

2.17 Welsh Government employees, as civil servants, are indemnified under their employment terms. However, for the reasons set out in [paragraph 2.8](#), it is uncertain whether that indemnity applied to the two civil servants in their capacity as RIFW Board members. The three external Board members were not Welsh Government employees and so were uninsured. In December 2010, Mr Richard Anning stated that his acceptance of a position as an independent member of the RIFW Board was conditional upon confirmation of indemnity cover. However, the Welsh Government failed to provide this assurance to Mr Anning in spite of his repeated requests and so, in August 2011, the RIFW Fund Manager was instructed by the Chair of the RIFW Board to take out a commercial professional indemnity insurance policy on behalf of all Board members, at RIFW's expense.

The Board's small size meant that any absences impacted upon its capacity and the volume of Board business placed a substantial burden upon the members, some of whom were unpaid

2.18 The relatively small size of the Board meant that its capacity to discharge its functions and scrutinise RIFW's operations would be insufficient in the event that any conflicts of interest arose from Board members' other roles. A Board member's absence or inability to participate in a discussion and decision would inherently weaken the Board. Whilst the RIFW Management Agreement contained provision for appointing proxies, this would have been inappropriate in relation to conflict and was not invoked by any of the Board members. However, there was no provision for substitutes. If there had been such a provision, the Board's capacity need not have been reduced if a conflict occurred. Capacity was further constrained when one of the two Welsh Government officials on the Board (the Chair) resigned in July 2011 and a replacement Welsh Government official was not appointed until July 2012. We have seen no evidence that the Welsh Government considered increasing the Board's size.

2.19 The unpaid external members were appointed to assist the Fund in achieving its investment objectives because of their knowledge and expertise in the Welsh commercial property arena. However, their extensive connections within the market inevitably raised the potential for real or perceived conflicts of interest to arise in relation to potential investments, as well as in respect of the asset disposals. Such circumstances resulted in one of the external members being absent from Board discussions in relation to the sale throughout the duration of the property transaction (from March 2011 to March 2013)²³.

2.20 It was originally intended that the RIFW Board's role would be limited to oversight of the Investment and Fund Managers' delivery of the RIFW Business Plan after the Board had approved it. However, the RIFW Board's decision to proceed with a portfolio sale was a departure from that approved Business Plan, which meant that Board Members became directly involved in decision-making relating to the disposal. As a result, the time commitment of just four days per year which was anticipated for external members proved to be wholly insufficient for the Board's business. Between January 2011 and October 2012 the Board members met 11 times. This higher than expected frequency placed very considerable demands

²³ References to 'the RIFW Board' in this Report in relation to the portfolio sale transaction should be taken to exclude Mr Geen, because he was not present during discussions, took no part in decisions, did not receive any relevant documents and was not copied into relevant correspondence.

upon all Board members and most particularly upon the independent member who attended meetings throughout the land transaction, which dominated this period; and during which the other independent member did not participate fully due to a conflict of interest. In addition, one of the other external members was absent from Board meetings in early 2013 for personal reasons²⁴.

The Fund and Investment Managers’ appointments resulted in complicated contractual relationships between the Welsh Government, the managing agents and their sub-contractors

- 2.21 In August 2009, the Welsh Government placed an advert in the Official Journal of the European Union announcing that it would seek Fund and Investment Managers for RIFW. In February 2010, the Welsh Government invited tenders from companies to support the RIFW Board, as its Fund and Investment Managers.
- 2.22 The Investment Managers Agreement required the Investment Manager to: ‘Act in a competent and efficient manner and in the best interests of the Fund Manager and the Partnership so as to give to the Fund Manager and the Partnership the full and complete benefit of the Manager’s experience and expertise in relation to the Properties.’ The Investment Manager was also expected to fulfil the functions of a responsible land owner, including asset management and maintenance, and to undertake activities to protect and promote the value of the assets within the RIFW portfolio prior to their disposal. Any expenditure on physical improvements to the assets themselves had to be funded through the Welsh Government’s cash contribution to the Fund or via rental incomes or sale proceeds, because European funds cannot be used for this purpose.

Box 4 – The Invitation to Tender (ITT) included information on the Fund’s purpose and objectives as well as the managers’ respective roles and responsibilities:

<p>Fund Manager:</p> <ul style="list-style-type: none"> • managing the cash held by RIFW; • evaluating and making investments in suitable projects within the Fund’s objectives; and • managing the Investment Manager’s activities and performance. 	<p>Investment Manager:</p> <ul style="list-style-type: none"> • responsibility for identifying and scrutinising investment opportunities; • making investment recommendations to the Fund Manager; and • managing the Fund’s land and property assets to create and realise maximum value for RIFW over time, thereby generating cash for investment in regeneration schemes.
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2.23 In December 2010, the Welsh Government appointed two companies jointly to support and advise the RIFW Board, to manage funds and investments. Amber Infrastructure Limited (Amber) and Lambert Smith Hampton Group Limited (LSH) bid successfully as a consortium. Amber was appointed as Fund Manager and LSH was appointed as Investment Manager. The contracts were awarded following a

²⁴ Councillor Holley

procurement process which, although compliant with procurement rules, involved only limited competition from one other consortium bid (three potential bidders were shortlisted, but one withdrew and only two bids were received).

Complicated contractual arrangements between RIFW and its advisors hampered effective oversight

- 2.24 The Welsh Government decided to appoint the investment and fund managers on a consortium basis. Such arrangements are not uncommon but resulted in complicated contractual relationships between the Welsh Government, RIFW itself, Amber (the Fund Manager), and LSH (the Investment Manager) which was itself a sub-contractor of Amber.
- 2.25 The contractual relationship between RIFW and Amber is governed by the terms of a Fund Management Agreement and the relationship between RIFW, LSH and Amber, by an Investment Management Agreement. Amber is also a non-voting member of the RIFW Partnership. Amber is responsible for all the day-to-day investment operations. An Amber employee and an LSH Director attend all Board meetings but are not voting members of the Board. An LSH employee is the nominated contact for external enquiries in relation to potential investment in regeneration projects.
- 2.26 In its capacity as a non-voting LLP member, Amber was in a similar position to all of the other Board members in relation to the level of reliance they were entitled to place upon professional advisors. However, because LSH was a sub-contractor of Amber, in its capacity as the Fund Manager, Amber had a duty to manage and supervise LSH. The RIFW Business Plan, approved by the RIFW Board in 2011, allocated responsibility for managing LSH's performance as a sub-contractor to a named Amber employee. The legal contracts agreed between RIFW LLP, Amber and LSH resulted in complex arrangements in which there was simultaneously a tripartite relationship between the three as well as a bilateral relationship between Amber (as principal) and LSH (as agent). This complexity created a degree of ambiguity and confusion between the parties, which has been reflected in their differing portrayals to us of their respective responsibilities and relationships to each other.
- 2.27 It is clear from the requirements of the asset-specific plans that the Welsh Government expected that the Investment Manager would seek opportunities, where appropriate, to enhance the potential value of the assets through the planning process, and would recommend disposals to give the best financial return for the Fund, taking account of the match-funding constraint. The fee structure incentivised this expectation through the sliding scale of success fees based on asset disposal proceeds above a baseline related to the 'transfer value', payable to the Fund Manager and the Investment Manager. Update reports prepared by LSH for monthly meetings with Amber show that LSH was indeed actively engaging with local authorities to promote the assets through the planning process. In practice, however, the extent to which LSH was able to do this was constrained by EU match-funding rules and also by the need to avoid creating any conflicts for Welsh Ministers between their ownership of RIFW and their statutory powers of intervention on planning issues.

Box 5 – The RIFW Investment Management and Fund Management Agreements

The Investment Management Agreement specified that services would be provided by LSH (as Amber's sub-contractor) consistent with 'good industry practice'. It went on to define the standard required as that which may be expected of a competent and experienced manager undertaking similar work with regard to Royal Institution of Chartered Surveyors (RICS) codes of conduct and guidance. The Agreement required any potential conflicts of interest to be disclosed fully and in advance. The Investment Management Agreement also required that both Amber and LSH should use their best endeavours to ensure compliance with EU requirements, including in relation to state aid. The Fund Management Agreement included similar specific provisions. Both agreements also specified levels of indemnity insurance required by the managers against losses incurred as a result of fraud, negligence, misconduct, recklessness or breach of agreement; and each manager was required to have £10 million of insurance cover in place.

The Investment Management and Fund Management Agreements set out the fees that the Investment and Fund managers can respectively charge RIFW for their services, including a success fee payable upon asset disposals. For the Investment Manager, their fees include management fees for managing the assets whilst in RIFW's ownership. The Fund Manager receives fees from fund management, based upon the size of the Fund. The Investment Manager and the Fund Manager would also both benefit financially from successful investments, as they were incentivised through the variable fees structure.

The two agreements also set out the respective managers' duties. These included producing a business plan to be prepared by the Fund Manager, agreed by the RIFW Board on behalf of the Partnership and to be reviewed annually. The initial business plan was required to cover a two-year period. Within the business plan, the Investment Manager was required to produce an asset realisation plan for disposal of the Fund's property assets, including asset-specific plans which were to be reviewed every six months.

The agreements specified that the asset realisation plan should include:

- a profile of cash requirements, setting out when cash is needed from asset disposals in order to be reinvested and defrayed by 2015;
- detailed cash flow projections estimating when and how much cash is likely to be generated from the future realisation of each of the assets;
- information on the timing and amount of any anticipated asset promotion and management costs; and
- recommendations to the RIFW Board regarding whether each asset should be:
 - prioritised for immediate sale;
 - held for short-term promotion and sale; or
 - held for longer-term promotion and subsequent sale.

The asset-specific plans were also required to include:

- a summary of information on each of the assets, including value, title, survey, risks, costs;
- a plan for enhancing the value of the asset;
- an exit strategy which optimises financial returns from the asset;
- resource management information; and
- a financial report, including detailed forecast cash flows for each individual asset.

A review commissioned by the Welsh Government has identified weaknesses in the governance arrangements that it established for RIFW that are also relevant to other arms-length agencies

- 2.28 In February 2013, the Minister for Housing, Regeneration and Heritage announced that the Welsh Government would commission an independent internal review of RIFW's governance. Its purpose was to provide assurance to the Welsh Government's Director of Governance that RIFW's governance arrangements are efficient and effective to enable it to deliver the outcomes for which it was established, and to make recommendations for improvements where necessary.
- 2.29 This review was conducted by Mr Gilbert Lloyd²⁵, a retired KPMG partner, and focused upon:
- a the establishment and composition of the RIFW Board, the Board's responsibilities and its associated operating arrangements;
 - b the selection and appointment of Board members;
 - c procedures and practice in relation to the management of any conflicts of interest;
 - d effectiveness in the operation of the Board and associated meetings;
 - e actions of the Board and its members with reference to their terms of appointment and the terms of reference of the Board;
 - f decision-making processes and adherence with protocols; and
 - g the effectiveness of risk management.
- 2.30 The results of the independent review (the Lloyd Report), which were not fact checked in their entirety with the Board members, were reported to the Welsh Government in April 2013. The Lloyd Report did not contain an overarching conclusion in relation to the efficiency and effectiveness of governance arrangements for RIFW, but did provide conclusions and recommendations in relation to specific aspects of RIFW's governance. The Report was broadly positive in relation to the conduct of RIFW Board meetings, with the exception of the management of conflicts of interest (see also paragraphs 3.101 to 3.111). However, it identified a lack of clarity in relation to RIFW's accountability arrangements and the need to correct this in relation to the oversight of arms-length agencies more generally.

²⁵ Mr Gilbert Lloyd served as an independent member of the Wales Audit Office's Audit and Risk Assurance Committee until 30 September 2014. Both the Auditor General and the Welsh Government are content that this did not create any conflict of interest for Mr Lloyd's independent review.

Box 6 – Recommendations of the Lloyd Report

The Lloyd Report contained recommendations that the Welsh Government should:

- i. establish and implement a framework for dealing with arms-length bodies, including RIFW, and revisit its procedures to ensure that the requirements regarding attendance at Board meetings set out in Principal Accounting Officer Note 003: **Attendance at and Membership of External Boards and Committees** are applied consistently to arms-length bodies in addition to Welsh Government sponsored bodies;
- ii. identify the most appropriate organisations that are most likely to be able to help in the recruitment of individuals with particular skill sets for public appointments;
- iii. address the issue of resourcing at Board level, give immediate consideration to appointing additional members to the RIFW Board, set formal terms of reference for the RIFW Board, and adopt a realistic approach to estimate time commitment and reward for external non-executive appointments;
- iv. ensure that the reasons for selection of candidates for interview or advancement at any stage of an appointments process should be clear and supported by gradings which leave no doubt as to priority;
- v. formally recognise the appointments of Welsh Government officials on the RIFW Board and provide them with letters of appointment and clarify the periods of appointment for the two independent external Board members;
- vi. create and implement a policy for provision of professional indemnity for external non-executive director appointments to Welsh Government Sponsored Bodies, Welsh Government Arms-Length Bodies and other similar bodies;
- vii. involve officials from the Welsh Government Corporate Governance Unit in the training and induction of boards similar to RIFW;
- viii. complete drafting of a Principal Accounting Officer note on managing conflicts of interest, followed by adequate communication and training, and strengthen the terms of appointment of RIFW Board members, and those of similar bodies, to include an express requirement to obtain permission prior to embarking upon activities which could involve creation of conflicts; and
- ix. revisit, clarify and reissue the terms of Councillor Chris Holley's appointment to the RIFW Board, and consider Mr Jonathan Geen's request that he should be replaced on the RIFW Board given the implications of his continued involvement with clients who are or may become conflicted with RIFW activities.

In addition to recommending actions by the Welsh Government, the Lloyd Report also recommended that the RIFW Board should:

- i. adopt a policy on whistleblowing and add it to their Operating Manual;
- ii. strengthen RIFW's policy on conflicts of interest to bring it into line with that of the Welsh Government itself; and
- iii. design and implement a review of its effectiveness against its terms of reference.

- 2.31 A sub-committee of the RIFW Board, the Audit and Risk Sub Committee is responsible for reviewing the risk register and internal controls framework, as well as recommending the appointment of external auditors, receiving audit reports and recommending approval of financial statements to the RIFW Board. The Lloyd Report recommended that the Welsh Government should:
- a examine protocols for appointing external auditors to RIFW; and
 - b extend the scope of external audit to include providing an opinion on regularity (in addition to the audit opinion on the truth and fairness of the financial statements) in connection with RIFW's affairs.
- 2.32 We endorse the recommendations of the independent governance review. We also note that its findings accord with the conclusions from our own fieldwork in identifying weaknesses and omissions in relation to:
- a the appointment of Board members;
 - b the time commitment for, and remuneration of, the external Board members;
 - c the Board's size and composition, particularly with reference to the need for it to acquire additional expertise in investment management, banking and accountancy; and
 - d delays in replacing one of the Welsh Government representatives on the Board which, combined with absences of one external member due to personal circumstances (unconnected with RIFW business) and of another external member due to a declared conflict of interest, hampered the Board's capacity to discharge its functions effectively.
- 2.33 Our fieldwork identified that the record of meetings of the RIFW Board members is incomplete, as we have not been able to locate any notes of an 'ad hoc' meeting of the Board held by telephone conference on 28 April 2011. At this meeting, we understand that the Board members decided 'in principle' to dispose of the asset portfolio to GST Investments. Amber told us that this was not a formal Board meeting. However, the meeting's purpose was to seek specific direction from the Board for a material change to the Asset Realisation Plan (approved by the Board within the First Business Plan). Therefore, we believe that it should have been minuted; but note that decisions taken at that meeting were ratified by the Board at its next formal meeting on 5 May 2011. Sometimes, crucial Board meetings to discuss and approve decisions regarding the portfolio disposal were called with very little notice to consider time-sensitive matters. Notably, one Board meeting, held as a telephone conference, was convened the same day as notice was given, based on a majority decision to waive the usual minimum requirement for 10 days' notice.

- 2.34 We found that Minutes of Board meetings recorded key decisions and actions, but did not provide documented evidence of the level of scrutiny and challenge. The Board members have informed us that they took a pragmatic decision to produce the minutes in this way in order to reduce the volume of paperwork. Whilst this style of minutes is commonplace in the private sector, it is good practice in the public sector for minutes to record the key elements of the discussion and decision process, as well as the outcome itself.
- 2.35 We have also identified an issue of non-compliance with the RIFW Members Agreement. A resolution of the Board on 9 June 2011 did not comply fully with the relevant terms of the Members Agreement because insufficient Board Members were present, and so was not valid. The Board resolution in question was linked to the decision to approve the sale of the RIFW asset portfolio, albeit that this was superseded by a subsequent, valid resolution of the Board concerning the final terms of sale, on 31 January 2012.
- 2.36 In February 2013 the Welsh Government announced it was commissioning Deloitte to conduct an independent peer review of the professional advice received by the RIFW Board in relation to the disposal of the asset portfolio²⁶. Deloitte reported its results to the Welsh Government in August 2013.
- 2.37 We note for the record that the findings of this detailed peer review were not cleared for factual accuracy, completeness and fairness of presentation with the various parties (other than the Welsh Government itself) who are named within it, before Deloitte issued it to the Welsh Government in its final form. Such clearance is part of the usual standards applied by the Auditor General for his own audit reports.
- 2.38 However, having considered the content of Deloitte's report, the Welsh Government concluded that it provided evidence in relation to the quality of professional advice provided to the RIFW Board and upon which the Board made decisions that the Welsh Government would need to take into account in its monitoring of the Fund. Our own audit fieldwork has identified that certain elements of the professional advice provided to the Board in respect of the asset portfolio disposal were flawed, insufficiently complete and/or potentially misleading. These matters are considered in detail in **Part 3** of our report.

²⁶ **Welsh Government Peer Review – RIFW Asset Portfolio Disposal**, undertaken by Deloitte and reported to the Welsh Government in August 2013.

Part 3

Due to flaws from the outset, the Welsh Government and RIFW cannot provide public assurance that the land and property portfolio sale achieved value for money



Part 3 - Due to flaws from the outset, the Welsh Government and RIFW cannot provide public assurance that the land and property portfolio sale achieved value for money

The Welsh Government selected a mixed portfolio of assets for RIFW to sell, including many which were not ready for sale and some which had potential for significant uplifts in value

To establish the Fund, the Welsh Government transferred to RIFW a mixed portfolio of property assets with values based upon the assets' existing usage

- 3.1 The Welsh Government possessed a portfolio of property assets, many of which had been in public ownership for decades and had been transferred to the Welsh Government from the former Welsh Development Agency and Land Authority for Wales when these bodies were wound up in 2006. When the need arose in June 2009 to provide property assets to RIFW as a substitute for cash, in order to establish the Fund and to match EU funding via WEFO, the Welsh Government began to compile a long list of potential assets in Welsh Government ownership which were not required for other policy purposes. Some long-list sites were rejected on advice from the Welsh Government's Commercial Legal Services Department (Legal Services) due to title issues.
- 3.2 In July 2009, the Welsh Government instructed King Sturge to provide a valuation of the 23 property assets it had shortlisted for potential transfer to RIFW²⁷. In December 2009, King Sturge provided a report as at October 2009, quoting a total value for these potential transfer sites of between £29,831,000 and £35,581,000. The £5.75 million difference between these figures represented the 'hope value'²⁸ that King Sturge attached to five of the properties, to reflect that these assets had potential for uplift in value if the assets' planning status changed from their existing use. The King Sturge valuation report stated that the valuations of six assets²⁹ were based upon existing agricultural use and for a further asset upon existing industrial use. If sold, the seller's interests should be protected by overage³⁰ clauses. Individual valuations were also provided for each of the property assets but, importantly, the total figures represented aggregated individual valuations. The Welsh Government had not instructed King Sturge to provide a market value for the entire portfolio as a single sale; likely to be a smaller amount³¹.
- 3.3 The report of the District Valuer, commissioned by the Auditor General, identifies some inconsistency in the valuation basis adopted in King Sturge's report which could have led to each of the individual site valuations provided to the Welsh Government being potentially lower than market value. This inconsistency may have arisen from the Welsh Government's instructions in relation to providing valuations based on existing use or market value. There was also ambiguity in relation to the Monmouth and Brackla assets for which King Sturge did not provide

27 Including assets not subsequently transferred and excluding Brackla, which was transferred – see Box 7.

28 The King Sturge valuation report gives valuations based upon existing use and attaches 'hope value' to assets with potential for uplift, but does not provide specific market valuations for each of these assets, although with 'hope value' reflects market value.

29 King Sturge did not identify a 'hope value' for the Monmouth and Brackla assets but did list them amongst those for which the seller's interests in future uplift should be protected by overage if sold.

30 'Planning clawback' is a payment arising from an enhancement in the value of the property triggered (usually) by the granting of planning permission. The claw-back payment is a percentage share of such a difference in value.

'Overage' arises from development in accordance with planning permission and represents a percentage share in the revenue generated from subsequent sales.

The term overage was used by all the parties throughout the sale transaction, although the actual agreements should more accurately be described as 'clawback'.

31 The District Valuer has applied a portfolio sale discount of 15 per cent, see Appendix 3.

a 'hope value' but which they did identify as having potential for a future uplift in value which, if sold, should be protected by overage.

- 3.4 In February 2010, Welsh Government officials within the Department for the Economy and Transport met to consider the short list and determine the final selection of assets to be transferred to RIFW. Some potential assets were rejected as being unsuitable for transfer. The officials involved in the selection intended that RIFW should receive a mixed portfolio of assets, within which some would be more attractive and some less attractive to the marketplace.
- 3.5 Three principles therefore guided the Welsh Government's selection process, these were that the assets transferred to RIFW should be:
 - a attractive to the market, easily saleable, and with a clear legal title;
 - b without any third-party impediment to a sale; and
 - c capable of being sold within the timescale determined by the Fund's requirements for cash to invest in regeneration projects.
- 3.6 Overall, the total value of cash and assets in the portfolio (as determined by King Sturge), was intended to be sufficient to meet RIFW's investment match-funding requirements and also provide additional funds. However, the potential for significant uplift in value was not considered explicitly in the selection process, although it was recognised that several of the assets that were selected offered opportunities for development and, therefore, would be particularly attractive to the marketplace.
- 3.7 The decision to include these assets in the transfer had the effect of giving RIFW the responsibility for balancing the immediate need for, and benefits to RIFW of realising cash for investments against continuing ownership costs and any potential longer-term uplift in value. As the Board members' individual and collective responsibility was to the RIFW LLP, rather than to the Welsh Ministers, this tension increased the inherent risk that the maximum potential sale returns might not be realised.
- 3.8 Given the Welsh Government's policy objective to encourage regeneration during a deep recession, if the Welsh Government had been prepared to accept that the maximum asset sale proceeds potentially achievable over a longer time-frame would not be realised, then its acceptance of this outcome should have been explicitly stated in the JESSICA Business Plan.
- 3.9 The report of the District Valuer (commissioned by the Auditor General), values the property assets actually transferred to RIFW at a total of £31,775,000 as at October 2009 (the original King Sturge valuation date); and £32,770,000 as at March 2010 (the transfer date). These totals represent the sum of the individual market values, rather than existing use values, and did not assume a portfolio sale at a discount.

Box 7 – The assets transferred to RIFW by the Welsh Government

The majority of the assets selected for transfer were transferred from the Welsh Government's ownership to RIFW in June 2010, once the interim estates management arrangements were in place. The selection of the assets for transfer was controlled by the departmental central team, with input from Welsh Government regional offices as needed. Each transfer was approved by the relevant Welsh Government Regional Director. The transfer from Welsh Government ownership to RIFW was identified on the property title deeds and recorded at the Land Registry, along with the values at which the assets were transferred, as valued by King Sturge. Registering the assets' titles at HM Land Registry took place between April 2011 and February 2012, after the April and June 2010 transfer dates. The transfer between government bodies did not involve any payment in return and did not incur stamp duty liability.

Brackla Industrial Estate was also transferred to RIFW, but had not been included in the King Sturge valuation report because it was not on the original list that the Welsh Government had identified for potential transfer. Brackla was valued under separate instruction by King Sturge in February 2010 at £5,500,000 as at October 2009; the same valuation date as the other assets.

Not all of the 23 property assets that had been identified by the Welsh Government for potential transfer and valued by King Sturge, as at 1 October 2009, were actually transferred to the RIFW portfolio. The exclusions were:

- Croes Atti, Okenholt, Flint
- Ynysallan Farm, Llantrisant
- Gwynfaen Farm, Loughor, Swansea
- South Sebastopol, Cwmbran
- Glasdir Road, Ruthin
- Hotel Site, St Asaph Business Park

In addition, most of Wrexham Industrial Estate, which was valued by King Sturge at £2,450,000, comprising 137 acres, was not transferred. The value of the asset actually transferred was identified as £390,000, comprising just 16 acres. Part of the overall Imperial Park, Newport site (which encompassed Imperial House and Imperial Courtyard), together with land adjacent to Imperial Courtyard with a value of £100,000, did not transfer to RIFW because, subsequently, the Welsh Government discovered that it did not actually own it.

The net effect of these various additions and exclusions is a reduction of £9,281,000. Reconciling these changes with the aggregate King Sturge valuation figure gives an aggregate market valuation for the portfolio of assets actually transferred to RIFW of £20,550,000 based upon existing usage, and an upper value of £26,300,000 (including 'hope value', which reflects market value). For accounting reasons, because 'hope value' could not be taken into account for match-funding purposes, the Welsh Government identified that the 18 assets that were transferred to RIFW were worth £20,627,000³² (the 'transfer value'), which had the effect of transferring the assets to RIFW at values based upon their existing use. The transfer date was deemed to be 10 March 2010, although the registration of legal titles was not completed on this date. On 24 March 2010, King Sturge confirmed to the Welsh Government that the aggregated valuations of the 18 property assets transferred to RIFW were between £20,650,000 and £26,400,000. The higher figure represented with 'hope value' and both figures included £100,000 of land which was not transferred.

³² Documents are inconsistent in relation to the 'transfer value'. The 'transfer value' is quoted in the **JESSICA Business Plan** as £20,650,000, which reflects the King Sturge valuations (without 'hope value'), both dated March 2010. However, **The Members Agreement** and the **WEFO Offer Letter**, both dated October 2010, state the 'transfer value' as £20,627,000. Both of these 'transfer value' figures include the land adjacent to Imperial Courtyard that subsequently was not transferred to RIFW and therefore both figures overstate the aggregate existing use value of the assets by £100,000.

After the transfer from the Welsh Government to RIFW, it became apparent that information on the assets was inaccurate and that many of the property assets were not actually ready for marketing and sale to realise cash for the Fund

- 3.10 The Welsh Government's Commercial Legal Services Department (Legal Services) acted as seller for the land on the Welsh Government's behalf during the transfer of the property assets to RIFW. This did not involve any of the searches or due diligence normally carried out by a buyer's solicitors.
- 3.11 As a result, the process of conveying the assets' legal titles from Welsh Government ownership to RIFW did not involve the level of scrutiny that would be involved in an open-market sale. During initial work by LSH on preparing RIFW's Business Plan and Asset Realisation Plan and in response to queries from the eventual buyer of most of the sites during sale negotiations, it became increasingly apparent that there were unresolved issues with some of the sites.
- 3.12 In March 2011 the RIFW Board therefore resolved to commission its own legal due diligence on the assets, in order to ensure that each asset could be made readily marketable and saleable. Following a procurement process conducted within a Welsh Government framework agreement, a firm of lawyers was instructed to undertake the work and identified:
 - a issues in relation to registering legal title to the majority of the assets with the Land Registry;
 - b defects in relation to legal title, boundaries and access rights, including some land identified on asset site plans not being in Welsh Government ownership and some 'missing' land identified on site plans not being included in legal titles transferred to RIFW; and
 - c previously unidentified issues and risks in relation to tenancies, occupational interests and protected employment rights.
- 3.13 RIFW's legal advisors subsequently worked in conjunction with Legal Services to resolve the issues or to mitigate risks in order to ensure that registration of RIFW's legal titles to the assets could be completed at the Land Registry and that the assets were saleable to the subsequent purchaser of most of them, on the terms agreed. In addition, the Imperial House asset had defects in the condition of the building which would require significant capital expenditure before it could be let and there were also rent arrears. SWLD took on these costs under the terms of the sale transaction.

Several of the assets transferred to RIFW had long-term development potential and so swift disposals to meet RIFW's anticipated short-term cash flow needs were unlikely to maximise the potential returns

3.14 The potential for enhanced values (as a result of future changes in planning status) for several of the sites transferred to RIFW was recognised from the outset by the Welsh Government and was reflected in the Investment Manager's Agreement. The Investment Manager (LSH) role was not to act as a developer but was expected to promote the assets through the planning process, seek opportunities to enhance value and to recommend disposals to give the best financial return for the Fund, incentivised by the success fee mechanism. However, RIFW's negotiating position was constrained and it was under pressure to sell its assets at times that would not necessarily produce maximum potential returns because:

- a RIFW's core purpose was to make investments; holding, managing and disposing of property assets was therefore a distraction from this, necessitated by the shortfall in Welsh Government cash funding available to establish RIFW;
- b RIFW needed to have sufficient cash to meet the funding needs of the projects in its investment pipeline;
- c any asset sales that delayed investments beyond 2015 (making the investments ineligible for EU JESSICA match-funding) would have to realise greater proceeds to compensate for this, unless other funding schemes became available;
- d maximum value from sites offering the greatest uplift potential could only be realised following inclusion within a Local Development Plan and granting planning consent; these were lengthy and uncertain processes which were beyond RIFW's influence and might well extend beyond 2015;
- e both the purchaser appetite and the availability of bank financing for property asset acquisitions had been depressed by the recession and so market conditions, particularly for the type of investment assets in the RIFW portfolio, were not conducive to achieving the best potential sale price; and
- f the value of the assets, based largely on existing use as at October 2009, was known to the market (although over time, this information would have become out of date and so less relevant to any sale negotiations).

3.15 The District Valuer's report highlights that:

'...in the case of some of the largest and potentially most valuable sites (e.g. Lisvane and Monmouth, which are not suited to a conventional upfront sale) realising their full value is a process that may take some time and resources, which may include the use of specialist master-planners and/or co-operative arrangements with a developer (or consortium of developers).'

The District Valuer also questions:

'...to what extent RIFW had the time, means and opportunity to achieve the best possible sale prices for all of the assets'.

3.16 It was reasonable for the Welsh Government to sell surplus assets in order to fund policy priorities. However, because of the market conditions and the constraints under which RIFW operated, we consider that it would have been desirable for the RIFW portfolio ideally to have comprised stable income-generating assets with more predictable values offering little potential for uplift. Alternatively, more robust measures and greater oversight to mitigate the risk of failing to maximise returns through inopportune disposals should have been put in place by the Welsh Government and RIFW. In addition, the range of legal title issues and defects that were found to be associated with the assets meant that many of them, including assets which were expected to be disposed of quickly by RIFW to realise cash for the Fund, were not readily saleable.

When appointing advisors to RIFW, the Welsh Government made information available that would weaken RIFW's negotiating position when selling the properties

- 3.17 We have established that, at a very early stage in RIFW's existence and prior to it actually commencing any marketing activity, information regarding the Fund's assets, 'transfer values', cash requirements and realisation constraints became known within the Welsh property market. This information's release inherently weakened the Fund's negotiating position in relation to future property disposals.
- 3.18 The Welsh Government's ITT document and accompanying information for the respective managers' roles included details of the individual land and property assets within the Welsh Government's extensive holdings across Wales that were expected to be transferred into the RIFW portfolio³³. Importantly, this information included each of the individual values at which these assets were to be transferred into the Fund (these comprised both the existing use values and also the ascribed 'hope value' for those of the land assets that were considered to have future development potential³⁴). The Welsh Government thought this information's release was an essential element of the tender process and explicitly identified it as being commercially sensitive and to be treated in confidence.
- 3.19 The ITT documents were circulated to six shortlisted companies, elements of which had interests in the property sector in Wales and held extensive lists of clients who could be interested in buying the assets, including some who subsequently expressed interest. The application process, which generated two consortia bids, gave the opportunity for the shortlisted companies to tour the sites and view the assets, enabling them to form their own views of development potential, and of present and future value.
- 3.20 The information packs also explicitly included the Fund's requirement to dispose of enough of the assets so that when the sale proceeds were added to the Fund's existing cash holding, the Fund would have £15.4 million of cash to match-fund the £25 million investment of European funds in regeneration projects by the end of 2015. Therefore, the Fund Manager and the Investment Manager should have both been fully aware of RIFW's EU funding requirements.

³³ The list of assets included some that were not subsequently transferred to RIFW.

³⁴ See Appendix 3.

3.21 Prior to appointing the Fund and Investment Managers, the Fund operated under interim arrangements, with staff provided by the Welsh Government and accounting services provided by a private-sector accountancy firm. Following the asset transfer from the Welsh Government to RIFW, interim land portfolio management was provided by two property management firms. Thus, the interim arrangements also led to property companies knowing details of the assets and their values (see also [paragraph 3.83](#)).

The RIFW Board approved a business plan to sell the whole property portfolio before 2015, but the Board was not advised that the assets with the greatest development potential could have been retained for future disposal whilst still meeting EU match-funding requirements

3.22 The February 2010 ITT for the Investment Manager and Fund Manager positions required the Investment Manager to prepare an outline asset realisation plan as part of their response to the ITT. To assist in this, the Welsh Government included within the ITT information package a hypothetical Delivery Profile of potential investment projects. This profile envisaged that RIFW would invest the entire £55 million of Phase one funding (see [Exhibit 5](#)) by December 2015. The outline Asset Realisation Plan prepared by LSH, in response to the ITT, proposed a phased disposal of all of the property assets to provide the full amount of investment funds necessary to achieve the hypothetical Delivery Profile.

3.23 Following their appointment in December 2010, under the Investment Manager's Agreement, LSH was required to prepare an asset realisation plan, as part of RIFW's business plan '...to take account of the cash requirements of the Fund, identify value enhancement potential at a portfolio level and through planning consents'. The ITT information had stated that '...the maximisation of the asset value and cash generation will be an important component in the financial performance of the fund'. The Investment Manager was also required to prepare asset-specific business plans for review every six months; and to prepare site information packs for marketing the assets.

3.24 Amber prepared an Initial RIFW Business Plan for the RIFW Board to consider at the Board meeting on 31 January 2011. The Asset Realisation Plan within the Initial RIFW Business Plan was incomplete, but stated that the completed Plan would identify potential site opportunities, and understand planning and development scope. Working drafts of asset-specific business plans were also included with the Initial RIFW Business Plan in the Investment Manager's Report to the Board. The potential for a sale of the entire asset portfolio in a single transaction was not identified at this stage.

- 3.25 The Initial RIFW Business Plan, prepared in January 2011, was superseded by the First Business Plan, which contained the Asset Realisation Plan prepared by LSH and which was approved by the RIFW Board meeting on 28 March 2011. The Asset Realisation Plan's focus was on achieving phased asset liquidation by the end of 2014 to provide sale returns which could then be invested in regeneration projects, along with EU match-funding during 'Phase 1', to the end of 2015.
- 3.26 The Asset Realisation Plan and the asset-specific plans envisaged a variety of disposal routes and timescales for liquidating each of the assets within the RIFW portfolio, depending upon their individual characteristics, constraints and potential values; supported by open marketing. Disposal routes proposed included via auction, on the open market and by private treaty; timed to match the timescale necessary to access EU ERDF match-funding. Negotiated sales of individual assets to existing leasehold tenants were not considered.
- 3.27 Importantly, RIFW could have approved an Asset Realisation Plan for asset disposals that, along with RIFW's existing cash holdings³⁵, yielded the £15.4 million required for match-funding investments before the end of 2015, without selling the Lisvane and Monmouth sites in advance of the timescales for producing the relevant Local Development Plans. These two sites' inclusion within residential allocations in Local Development Plans would have very significantly increased these assets' values and hence the potential sales returns to RIFW during 'Phase 2' of the Fund, after December 2015. However, this option (which we acknowledge would have limited the size of the Fund available for investment at this early stage) was not presented to the RIFW Board.
- 3.28 The District Valuer's valuation of the RIFW portfolio as at March 2011, the time of the Asset Realisation Plan, assuming a phased disposal of the assets, is £34,339,000. The 'realisable value' quoted in the Asset Realisation Plan in the First Business Plan is £24,935,000³⁶. The combined value of the Lisvane and Monmouth assets quoted in the Asset Realisation Plan is £4.0 million.

RIFW wrongly believed that the whole asset portfolio had to be sold by December 2015 in order to satisfy ERDF match-funding requirements

- 3.29 From RIFW's inception, the Welsh Government recognised that some property assets transferred to RIFW offered potential for development and opportunities for enhanced value. In order to access ERDF funding, in March 2010, a JESSICA Business Plan was prepared for the Welsh Government to submit to WEFO. The JESSICA Business Plan included statements making it clear that although selling some assets would be necessary in order to meet match-funding requirements of £15.4 million to December 2015, potential for enhancing the assets' value should be explored, to meet RIFW's investment needs in 'Phase 2' of the Fund, beyond 2015. Therefore, although ultimately all the assets would need to be sold to realise cash for investments, and some projects were expected to be investment-ready, it was not necessary to dispose of all of the assets in 'Phase 1', to December 2015.

³⁵ RIFW's cash holding was £9.4 million at establishment in March 2010.

³⁶ LSH's assessments of 'realisable value' were not conducted to RICS standards.

3.30 In essence, RIFW was established with £9.4 million of cash to meet its operating costs, but this could also be used to contribute to the WEFO match-funding requirement of £15.4 million. It follows that RIFW had only to generate proceeds from asset disposals of £6 million plus operating costs to meet the WEFO requirement.

3.31 The Welsh Government's JESSICA Business Plan recognised this, as it stated: 'Of the assets transferred into the Fund circa £15.4m will be Match Funding for ERDF purposes. The remainder of these assets will be available for use by the Fund in line with the core objectives of RIFW. The Fund will need to dispose of all assets in order to realise cash for investment into schemes. The assets provide a range of opportunities from straightforward land sales through to potential development sites. Some of these assets currently produce income which will be retained by the Fund and used for investment in regeneration schemes.'

'The Asset Realisation Plan will be crucial to the Fund in two main ways. Firstly the conversion of the assets into cash and the investment of that cash into selected schemes is a pre-requisite of the match funding for the ERDF funds. Secondly the maximisation of the asset value and cash generation will be an important component in the financial performance of the fund.'

'It will be important to the Welsh Assembly Government that as well as providing the required amount of cash for match funding, work is undertaken during Phase 1 to protect/enhance the value of assets before gains are crystallised in the valuation of the Fund assets as part of Phase 2 negotiations.'

'The key risk relating to the match funding is that assets must be realised and turned into cash before the value they represent can be invested by the Fund. The risk to the match funding element is minimal as there is additional land and cash to the value of £14.6m, in excess of the £15.4m match required.'

3.32 The Welsh Government's JESSICA Business Plan containing these statements was shared with all of the prospective Investment and Fund Managers in the ITT documentation, and so Amber and LSH should have been familiar with them. In addition, the ITT document stated:

'...£15.4m of Match Funding is required, which will be provided by the Welsh Assembly Government in the form of a portfolio of commercial, residential and mix-use land and cash.'

'...the deadline for the defrayal of ERDF and match funds is the end of December 2015.'

'The WEFO Funding Agreement ("Funding Agreement") will contain the conditions which apply to the defrayal of both the ERDF and match funding resources. Suppliers should note that the Funding Agreement would only apply to the ERDF and match funds. Other monies within the Fund (e.g. additional land assets in excess of the match funding requirement, other cash and any private sector investment) are not bound by these terms.'

- 3.33 Notwithstanding the statements above, Amber and LSH both maintain that ERDF match-funding placed a requirement upon RIFW to sell all of the property assets in order to invest the proceeds in regeneration projects by December 2015.
- 3.34 The RIFW Board members involved in making the decision to sell the assets did not receive the JESSICA Business Plan or ITT documentation from either the Welsh Government or from their advisors, and so may not have been sighted of the detail of the ERDF match-funding requirements.

RIFW incorrectly believed that an indicative Welsh Government Delivery Profile required investment of the whole £55 million 'Phase 1' fund before December 2015

- 3.35 The ITT information for prospective Investment and Fund Managers included an indicative Delivery Profile of investment projects during 'Phase 1' of the Fund which had been prepared by the Welsh Government as part of their JESSICA Business Plan. The indicative Delivery Profile, if achieved, would have satisfied the ERDF match-funding requirement and also would have resulted in the whole £55 million of 'Phase 1' funding being invested. The Welsh Government provided RIFW with a pipeline of potential investment projects and envisaged that the Investment Manager, once established, would generate further investments. The JESSICA Business Plan stated:

Box 8 – Extract from the JESSICA Business Plan

'Due to the nature of this project 2 different Delivery Profiles have been created and submitted to WEFO. The first, known as the Delivery Profile, as shown on WEFO Online, sets out a hypothetical breakdown of the total eligible expenditure (£40.4m) as at March 2010, in order to facilitate the online claim and drawdown of ERDF. This Delivery Profile is as referred to in the WEFO Offer Letter and will also include start and finish dates of the project, accountant report dates and scheduled evaluation dates.'

'In addition, the Project Team have created an Expenditure Profile, using the WEFO format, which sets out indicative timing of when investments will be made by the Fund as well as when Output targets will be delivered. This is based on the indicative schemes in the financial model, and is attached at Appendix 9. This document is expected to be a key part of the Fund's Monitoring and Reporting processes as it provides a forecasting tool for the defrayal of ERDF funds.'

- 3.36 The Welsh Government expected that the Investment and Fund Managers would substitute the indicative information in the Profiles with real information and use those amended Profiles as monitoring and reporting tools to track progress towards achieving the targets³⁷ set out in the WEFO offer letter (for ERDF funds). Although the Delivery Profiles were therefore only indicative, Amber and the Board members believed that they imposed a requirement to invest the full £55 million of 'Phase 1' funding before December 2015; which necessitated liquidating the whole portfolio of property assets transferred to RIFW by the Welsh Government. In June 2011, Amber and LSH reported to the RIFW Board³⁸: 'Whilst there is not an immediate requirement for additional cash resources, the pipeline of projects under consideration is increasing and currently stands at £65 million, if all current Expressions of Interest are converted.'
- 3.37 Holding cash funds rather than property assets, which were a distraction from its core investment purpose, was attractive to RIFW. A single sale of the whole asset portfolio presented an opportunity to realise enough cash to invest the full Fund amount during Phase 1. Doing so would support regeneration across Wales, including investing in projects outside the ERDF designated convergence areas which did not involve EU funds. However, potential investment projects in the pipeline provided to RIFW by the Welsh Government were not 'investment-ready', progress with investments was slower than WEFO and the Welsh Government had anticipated (see [paragraphs 1.10 to 1.16](#)); increasing the risk that RIFW might not be able to invest the full amount of £25 million ERDF and £15.4 million of match-funding before the 2015 deadline. WEFO has confirmed that RIFW was incorrect in believing that it was required to sell all of the property assets by December 2015 for match-funding or because of the indicative Delivery Profile.

RIFW's plan for a phased disposal, including open marketing, was immediately overtaken by an initial offer to buy the whole portfolio in a sale by private treaty, and an expression of interest from another potential bidder

- 3.38 LSH received a letter dated 4 March 2011 from Barclays Wealth in Guernsey, on behalf of GST Investments Limited, offering to purchase the entire RIFW portfolio of assets for £23,000,000. The property schedule which accompanied the Barclays Wealth letter listed the assets covered by the offer, using summary sheets prepared by the Welsh Government for each asset, which did not include the subsequent King Sturge valuations. LSH had provided this summary sheet information on request to interested parties in advance of preparing more detailed and up-to-date buyer packs which were due to be compiled by them in order to market the properties actively. As explained in [Box 7](#), the information on the summary sheets was inaccurate because it included land not transferred to RIFW. The offer also included the Cogan Hall, Penarth property, part of which was already under offer to another buyer.

³⁷ The measures were outputs of RIFW's investment activity, such as the number of eligible projects supported by investment and the number of jobs created. Targets in relation to the measures were to be agreed between RIFW and the Welsh Government and were dependent upon the volume and viability of investment projects in the pipeline. There were no specific measures or targets in relation to asset disposals.

³⁸ [RIFW Portfolio Transaction Report – Supplement](#); 2 June 2011. This Report contained the recommendation to accept the revised offer from GST Investments.

- 3.39 The offer letter identified GST Investments as a limited company incorporated in Guernsey, administered and controlled by Barclays Wealth on behalf of Sir Stanley Thomas OBE, the sole beneficial owner. The letter was signed by Barclays Wealth for GST Investments and included terms and conditions to the offer:
- a the offer was made on the basis that information in the schedule of properties was correct, on the assumption that RIFW had good legal title to the properties as well as the right to sell them and that there were no defects that would affect value;
 - b in view of the costs that the buyer would be likely to incur, the buyer requested an exclusivity period of 56 days;
 - c the buyer reserved the right to set up a company for the purposes of the transaction, a special-purpose vehicle;
 - d the letter stated that the offer was a cash offer and proof of funds could be provided if required; and
 - e no claw-back (overage) provisions were included in the offer on any of the assets.
- 3.40 The GST offer letter stated: 'We have based our bid on the information within the Schedule and our understanding of the market value of the properties when they were transferred to RIFW... We assume that a formal valuation was undertaken prior to the transfer of the Properties... in order to take the development fund to the publicised £55M figure. It has been widely reported that the value of the Properties at that time was circa £20M...'
- 3.41 The First Business Plan was presented to the RIFW Board at the same 28 March 2011 Board meeting as the offer from GST Investments. LSH circulated the First Business Plan to Board members in advance of the Board meeting but after receiving the GST Investments offer letter. The First Business Plan included the statement '...consideration of a single portfolio disposal of all 18 assets should not be ruled out to mitigate risks relating to the more complex or less desirable assets'. However, no information was included about the potential return to be achieved by a portfolio sale, which usually involves a discount compared with the assets' aggregate value, nor any information on how the portfolio might be marketed.
- 3.42 In addition to the offer proposal letter of 4 March 2011 from GST Investments, on 8 March 2011, LSH received an email from Rightacres Property Company Limited (Rightacres), a property company based in Cardiff. Rightacres expressed its interest in negotiating a portfolio sale of the properties and attached a schedule of assets, dated 4 February 2011 with proposed values, suggesting a cash sale for £17.47 million, subject to Rightacres doing more research relating to the planning status of each site, plus overage in relation to the five sites at Lisvane, Monmouth, Rhoose, Pyle and Brackla.

A single portfolio transaction had potential to release cash quickly for RIFW to invest, but negotiations were complicated and elements of the sale took two years to complete

- 3.43 GST Investments' initial offer to purchase the RIFW portfolio of 18 assets for £23,000,000 was received by LSH in a letter dated 4 March 2011 and reported to the RIFW Board on 28 March 2011. The deadline for accepting the offer set out in the offer letter was 30 April. The Investment Manager's Report recommended that the Board should note the approach; that the investment and fund managers should prepare a report on the offer for the Board; and that the Board should aim to make a decision on the report's recommendation to proceed with a sale to GST Investments by 8 April 2011. A quick sale of the assets would have enabled RIFW to focus upon its investment activity as well as providing the cash to invest. During March and April 2011, correspondence between LSH and Amber highlighted potential issues with the Imperial Park asset. The Portfolio Transaction Report, provided to the Board in advance of the Board meeting on 28 April compared the GST Investments offer of £23 million with the 'transfer value' at £20.65 million and considered options for sale, including inclusion of overage and exclusion of Imperial Park. Rightacres' initial interest was reported to the Board in this report and compared with the GST offer (see paragraphs 3.38 to 3.42 and 3.86 to 3.91).
- 3.44 The April 2011 Portfolio Transaction Report highlighted the risk that some assets might not sell. This risk had not previously been identified and had not been reflected in the Asset Realisation Plan approved at the previous Board meeting. A sale of the entire RIFW portfolio in a single transaction would have mitigated this risk and would also have allowed the Fund to focus on its core role of investment in regeneration. The Portfolio Transaction Report considered the potential for securing an overage agreement in relation to the Monmouth site, recognising its potential for enhanced value but noted that achieving this might be at the expense of excluding the Imperial Park site from the sale, due to its potential downside risks. The report recommended that the Board 'give serious consideration to acceptance' of the offer at £23 million, subject to best efforts to agree overage terms in relation to Monmouth. Negotiations with Rightacres did not progress beyond their initial interest to a formal offer and so the GST Investments offer was the only offer for the whole portfolio to which RIFW gave serious consideration. The 28 April 2011 meeting of the Board members was conducted over the telephone and was not formally minuted, so the matters discussed at that 'ad hoc' meeting were ratified by the Board at its next formal meeting on 5 May 2011.
- 3.45 GST Investments' interests during the transaction negotiations were represented by Mr Langley Davies, a Cardiff-based businessman. On 2 May 2011, Mr Davies referred to the potential inclusion of an overage clause in relation to the Lisvane site and indicated that if this were the case, the GST Investments offer would be reduced from £23 million to £21 million. A RIFW Board meeting was called on 6 May 2011 specifically to discuss the GST Investments offer. The Fund Manager's Portfolio Transaction Report provided by Amber for this Board meeting along with a specific recommendation paper³⁹, both recommended accepting the GST

³⁹ Recommendation to RIFW relating to the proposed sales of the 'Properties' to GST; dated 5 May 2011.

Investments offer, but at £22 million with inclusion of overage for Monmouth and for Lisvane. We have not seen evidence of any offer from GST Investments on these terms, which represented a counter proposal from RIFW to the GST Investments offer of 4 March. The report and paper did not identify that the Cogan Hall Farm site was subject to an offer from another purchaser that had already been accepted by the RIFW Board⁴⁰.

- 3.46 The Board minutes for 6 May 2011 record a resolution to accept the GST Investments offer at £23 million, based on a 'warts and all'⁴¹ basis, with increased overage for Monmouth and unchanged overage for Lisvane. The Board decided that a contingency plan in accordance with the Asset Realisation Plan (for a phased disposal rather than a portfolio sale) should be maintained, but we have not seen any evidence that this was subsequently actioned. On 10 May 2011, Mr Davies informed LSH that GST Investments were no longer prepared to offer £23 million on such terms and suggested instead, an offer of £21 million with the option of excluding Imperial Park.
- 3.47 On 18 May, Mr Davies informed LSH that GST Investments would be prepared to offer £21 million in staged payments, with overage reduced from the terms agreed by the Board in May to those which had been proposed previously. On 27 May, LSH advised Mr Davies that a deal at £22.5 million in three instalments with overage on Monmouth and Lisvane as proposed previously, would be acceptable to Amber, subject to RIFW Board approval. On 1 June, Amber emailed LSH setting out how they wished to present information to the Board '...in a way that they can but approve'. Amber indicated to LSH that the RIFW Board had three main areas of concern that would need to be addressed in the final paper for Board approval. These were:
- a the appropriateness of a sale without a formal market test;
 - b whether the offer was sufficient; and
 - c whether the terms were appropriate, given the planning situation.
- 3.48 On 3 June 2011, Amber circulated a paper to the RIFW Board members⁴², recommending that the Board should accept the GST Investments offer at £22.5 million, paid in three instalments over 24 months, secured by RIFW retaining a legal charge over the assets until the final payment was received. Overage on Monmouth and Lisvane was included. (Separately, land at Penarth would be sold for £185,000 and at Brackla for £60,000 to other purchasers and so these assets were removed from the portfolio sale). The offer was benchmarked against the portfolio 'transfer value' of £20.65 million⁴³, which excluded any element of 'hope value' and so did not reflect the assets' market value. The paper compared payment of the sale proceeds by instalments favourably with the profile of individual receipts envisaged by the Asset Realisation Plan. However, the paper did not analyse the impact of staged payments upon the net present value of receipts

40 Although an appendix to the **Portfolio Transaction Report**, dated April 2011, summarised information from the Asset Specific Business Plans identifying that the preferred approach to the Cogan Hall site was to progress with the sale of part of the asset. Subsequent reports to the Board in June and July 2011 referred to the separate sales of parts of the Cogan Hall and Brackla assets.

41 Usage of this term during the transaction is considered in paragraph 3.95.

42 With the exception of Mr Jonathan Geen who had declared a conflict of interest.

43 This was the transfer value as quoted in the **JESSICA Business Plan** and which reflected the King Sturge existing use valuation, which was not the same as the transfer value in the **WEFO Offer Letter** or the **Members Agreement** (£20,627,000).

to the Fund when compared with a single payment. Paying the sale proceeds in interest-free instalments reduced the benefit to the Fund of a portfolio sale but was agreed in return for retaining Imperial Park within the sale. LSH provided a Supplemental Portfolio Transaction Report to the Board which recommended acceptance of the revised GST Investments offer and stated: 'With reference to GST Investments, we have exhausted any further negotiation and this is their best and final offer.'

- 3.49 On 9 June 2011, a Board meeting convened specifically for the purpose of considering the GST Investments offer resolved to accept the offer as recommended by the Fund Manager in the paper circulated on 3 June. Only two voting members of the RIFW Board were present at the meeting, one of whom, Mr Richard Anning supported the decision but abstained from the formal vote, pending receipt of indemnity insurance for all of the Board members (see [paragraph 2.17](#)). The resolution was deemed to be carried by a vote from the Chairman and an email vote received from Councillor Chris Holley. However, we have established that the email vote was invalidly made, and as a result Amber has since confirmed to us that insufficient Board Members were present for this to have been a valid resolution of the Board⁴⁴. On 15 June, LSH wrote to Barclays Wealth accepting the offer from GST Investments.
- 3.50 The initial offer proposal letter, dated 4 March 2011, from Barclays Wealth identified that the buyer could be a company set up specifically for the purposes of the transaction (see [paragraph 3.39](#)). LSH informed the RIFW Board in June 2011 that the proposed purchaser was to be a special purpose vehicle for the purchase, which would be confirmed. On 15 July 2011, Heads of Terms for the transaction were set out between RIFW and 'Newco Ltd'. The sale transaction described was for 18 properties but recognised that RIFW may not be in a position to dispose of Imperial Park and Garth Park. The purchaser's solicitor was identified as Mr Jonathan Geen, a RIFW Board member⁴⁵. The separate sales of land at Brackla and Penarth were not identified.
- 3.51 In December 2011, a Supplemental Transaction Report, prepared by LSH, informed the RIFW Board that the purchaser would be a Guernsey registered company, wholly owned by St Lawrence Property Investments Limited, registered in the UK and funded by GST Investments of Guernsey.
- 3.52 In January 2012, LSH informed the RIFW Board that the purchaser was now to be South Wales Land Developments Limited (SWLD), a company which had been recently registered in Guernsey⁴⁶. GST Investments provided loan finance to SWLD for the purchase. The sale provisions ensured that payment of the sale proceeds by instalments would be protected by legal charges over the assets. We understand that Barclays Wealth itself performed due diligence on South Wales Land Developments, confirming that funds were available, and provided this confirmation to RIFW. In addition, RIFW's legal advisors obtained appropriate confirmations as to the buyer's identity and the source of the purchaser's funds.

⁴⁴ This was superseded by a subsequent, valid resolution of the Board concerning the final terms of sale, on 31 January 2012. See [paragraph 2.35](#).

⁴⁵ Mr Geen is the independent Board Member who, in March 2011, had declared a potential conflict of interest to the Board. See [paragraph 3.105](#).

⁴⁶ SWLD was subsequently registered as a UK company in February 2014.

- 3.53 At the January 2012 RIFW Board meeting, the Board resolved to sell 15 assets to SWLD for £21.745 million. The Cogan Hall Farm, Penarth site and part of Brackla were sold separately and removed from the sale. Anchor Way, Penarth and Garth Park, Talbot Green were removed from the sale because they were deemed by SWLD to be of no value due to changes in their planning status. The remainder of the Brackla site would be sold to SWLD, subject to certain conditions being met in relation to planning. The status of the legal title of Imperial Park was still unclear at this point, but a reasonable time would be allowed for sale completion so that the remaining issues in relation to the site could be resolved. (Part of the site, the land adjacent to Imperial Courtyard valued at £100,000, had not been transferred to RIFW because the Welsh Government did not actually own it). Two voting members of the Board were present at the January 2012 Board meeting. These were the same two members who had previously voted to approve the disposal via the invalid Board resolution in June 2011. A third member provided his assent after the meeting, and we are satisfied that this decision did constitute a valid resolution of the RIFW Board.
- 3.54 In November 2010, prior to LSH's appointment, an offer of £185,000 had been received for part of the Cogan Hall Farm site, referred to in the Asset Realisation Plan of January 2011. The offer was accepted and the sale of part of the site was completed in November 2011. RIFW retains the remainder of the site which was not included in the portfolio sale. A separate offer for £60,000 for part of the Brackla site was received on 14 April 2011 and was also completed in November 2011. The remainder of the site was included in the portfolio sale to SWLD.

There were flaws in the sale process which was not supported by open marketing or an independent valuation, and there were gaps in information and weaknesses in professional advice

- 3.55 There were significant weaknesses in information, including ambiguities and omissions in the professional advice, provided to the RIFW Board. These created material misconceptions on the part of the Board and others and resulted in deficiencies in the sale process in several key respects. In particular, we found that the RIFW Board's evaluation of the proposed sale terms was limited by:
- a a misconception regarding the extent to which the value ascribed to the assets at the time of their transfer from the Welsh Government to RIFW represented a market valuation of the assets;
 - b a misapprehension that disposal of the entire asset portfolio by 2015 was a requirement of ERDF funding and was also necessary to meet a Welsh Government investment profile (see paragraphs 3.29 to 3.34);
 - c the absence of a full independent valuation of the assets prior to sale and by comparisons between the purchaser's offer and the 'transfer value', which took insufficient account of the development potential of many of the sites;

- d a lack of proper marketing of the assets either as a portfolio or as individual sites, as LSH's ability to actively market the assets had been constrained by the need to resolve problems with some of the sites (see paragraphs 3.73 to 3.85)
- e inconsistencies in the handling and reporting of interest from prospective purchasers to the RIFW Board;
- f ambiguity in reporting the GST Investments offer and the Rightacres initial interest to the RIFW Board, compounded by weaknesses in how these approaches were compared with each other and with extant asset valuation information; and
- g the implications of changes to the GST Investments/SWLD offer during the process of sale negotiation were insufficiently analysed and reported to the RIFW Board.

The RIFW Board's understanding of the assets' value was based upon a notional 'transfer value' set by the Welsh Government below the asset portfolio's market value, which in turn affected RIFW's evaluation of the purchaser's offer

- 3.56 In March 2010, the Welsh Government attached a 'transfer value' to the property assets transferred to RIFW, based upon the King Sturge valuations. King Sturge had identified 'hope value' in relation to five of the sites, reflecting potential for increased value arising from future changes in planning status⁴⁷. Because 'hope value' could not be used as a basis for EU match-funding within the JESSICA scheme, the 'transfer value' excluded 'hope value'. However, the higher (with 'hope value') valuations of the five sites more accurately reflected the sites' market values than the lower valuations based upon existing, mainly agricultural, usage. The difference between the two figures' 'hope value' represented was £5.75 million. By excluding 'hope value' the Welsh Government set the 'transfer value' below the assets' market value. In effect, from this point forward, a notional 'transfer value' identified by the Welsh Government for accounting purposes came to be regarded by RIFW and its advisors as representing the assets' market value.
- 3.57 In addition, Welsh Government officials have been unable to explain why the various documents that we have reviewed are inconsistent in relation to the 'transfer value':
- a the 'transfer value' is quoted in the Welsh Government's JESSICA Business Plan as £20,650,000, which reflects the King Sturge valuations (without 'hope value'), both dated March 2010; and
 - b the RIFW Members Agreement and the WEFO Offer Letter, both dated October 2010, state the 'transfer value' as £20,627,000.

Both of these 'transfer value' figures include the land adjacent to Imperial Courtyard that subsequently was not transferred to RIFW and therefore both figures also overstate the aggregate existing use value of the assets by £100,000.

⁴⁷ King Sturge identified that seven sites had potential for increased value but only attached a 'hope value' to five of these.

- 3.58 The King Sturge 'hope values' were not provided to the RIFW Board. The Asset Realisation Plan and asset specific business plans, approved by the Board as part of the RIFW Business Plan, did not identify 'hope value' although the RIFW Portfolio Transaction Report dated April 2011, prepared by Amber and LSH, identified an assumption of overage for the Monmouth asset (indicating that the site had potential for value uplift above existing use value) and stated 'An element of overage is included in the ARP for other sites...' but did not specify for which sites or the amounts involved.
- 3.59 The Asset Realisation Plan included asset-specific business plans containing 'realisation values', which were estimates by LSH based on their opinion of what the assets were worth, rather than independent formal property valuations undertaken to RICS standards. The LSH 'realisation values' took account of variations in the individual assets actually transferred to RIFW compared with the assets valued by King Sturge. The total LSH 'realisation value' (reported to the RIFW Board in January 2011) was £28,425,000,⁴⁸ which was above the Welsh Government's 'transfer value' for the portfolio of £20,627,000⁴⁹ and also the King Sturge with 'hope value' valuation of £26,400,000.
- 3.60 LSH reduced its estimate of the aggregate 'realisable value' of the assets from the Initial Business Plan value of £28,425,000 to the First Business Plan 'realisable value' of £24,935,000⁵⁰. This net reduction of £3,490,000 comprised adjustments in the values of individual assets which were ascribed either to changes in their status or due to issues becoming apparent that impacted adversely on their value. For example, the land at Llantrisant Business Park lost its employment status and so LSH reduced its value from £330,000 at transfer to a 'realisable value' of £200,000; Garth Park, Talbot Green was identified as a 'green wedge' and nature conservation site and so LSH reduced its value from £210,000 at transfer to a 'realisable value' of £50,000. Within the aggregated total, LSH increased the 'realisable values' of some sites compared with the 'transfer value' and identified improvements in the planning status of the properties at Lisvane, Wrexham, Bangor, Anglesey, Monmouth, Abergele, Llandudno and Brackla. However, the overall reduction and the individual adjustments it represented were not fully explained to the Board at the time.
- 3.61 The Asset Specific Business Plan Summary Recommendations, attached as an appendix to the RIFW Portfolio Transaction report dated April 2011 recommended an individual sale of the Lisvane asset to reflect hope value and with overage provisions to secure additional returns, subject to successful promotion through the Council's Local Development Plan process. However, there was a lack of clarity in relation to the 'realisable value' of the Lisvane asset. Due to an error, the First Business Plan included two different figures; £1,835,000 in the asset-specific business plan, which matches the 'transfer value' and £2,500,000 in the overall cash flow, which reflected the 'realisable value' LSH quoted in the earlier version of the Plan.

⁴⁸ To be achieved by phased disposals over a three-year period to the end of 2014, the LSH Asset Realisation Plan 'realisable value' included the land adjacent to Imperial Courtyard which did not transfer to RIFW.

⁴⁹ As stated in the **The Members Agreement** and the **WEFO Offer Letter**, both dated October 2010.

⁵⁰ LSH's assessments of 'realisable value' were not conducted to RICS standards.

- 3.62 Information provided to the RIFW Board for evaluating the GST Investments offer compared the offer to the 'transfer value' rather than the higher 'realisable value' or the King Sturge with 'hope value' valuation. The Portfolio Transaction Report, provided to the Board in advance of the Board meeting on 28 April compared the GST Investments offer of £23 million with the 'transfer value' at £20.65 million and also referred to the 'transfer value' as 'the book price'. The report stated: 'An offer for the 18 assets as a portfolio has now been received from GST Investments Limited in the sum of £23m against the asset transfer value of £20.65m.' The recommendations to the Board relating to the proposed sale to GST dated 5 May 2011 and 2 June 2011 compared the offer directly with the 'transfer value' of £20.65 million without including any references to the Asset Realisation Plan 'realisation value' total figure. The Supplemental Transaction Report dated 2 June 2011, provided a cash flow comparison for the period 2011-2014 of Asset Realisation Plan budgeted receipts from a phased disposal of £24,935,000; with total receipts arising from asset sales of £22,745,000, including the portfolio sale to SWLD and also separate sales of part assets at Cogan Hall, Penarth and Brackla. However, the document did not include an NPV analysis comparing a single payment of the portfolio sale receipts against payment of the sale receipts by instalments and did not compare the GST Investments' offer directly against the Asset Realisation Plan 'realisable value'.
- 3.63 No comparisons against the King Sturge with 'hope value' valuation were undertaken. However, Amber clearly understood that the 'transfer value' was based upon the King Sturge existing use valuations of the assets and excluded 'hope value.' We note that in an email response to a query from a Board member dated 9 June 2011, which was copied to the Chair of the RIFW Board, Amber stated: 'Can I also clarify that the King Sturge 'book value' is expressly the current use value for agricultural purposes and hence the unadopted (in the LDP) or 'without hope' value is deliberately the same.'

The contractual arrangements devised by the Welsh Government for calculating the asset disposal success fees payable to RIFW's advisors were unclear and did not sufficiently incentivise the maximisation of sale proceeds

- 3.64 The Investment Manager and Fund Managers were incentivised to maximise asset disposal receipts by a sliding scale of success fees based upon disposal proceeds above a baseline. These contractual success fees would be calculated based on establishing a 'net value realised' by deducting the 'initial appraised value' from the sale proceeds (see also [paragraph 2.27](#)). However, the 'initial appraised values' are unclear. This is because:
- a The Investment Management Agreement drawn up by the Welsh Government does not provide 'initial appraised values' and instead refers to the Schedule of Properties in the members' Agreement.
 - b The Schedule in the Members' Agreement lists the properties transferred to RIFW but does not include their individual values⁵¹.

⁵¹ An earlier, superseded version of the Members' Agreement did include individual King Sturge values, excluding 'hope value' but including £100,000 of land adjacent to Imperial Courtyard which did not transfer to RIFW.

- c The 'transfer value' of the whole RIFW asset portfolio stated in the WEFO Offer Letter and the Members' Agreement (£20,627,000) is not the same as the King Sturge aggregated existing use valuation dated March 2010, quoted in the JESSICA Business Plan (£20,650,000). Both of these figures include land adjacent to Imperial Courtyard which was not transferred to RIFW (£100,000).
 - d It is also unclear how the 'initial appraised value' relates to the King Sturge valuations of individual assets, particularly where lower (existing use) and higher (with 'hope value') figures are quoted.
- 3.65 SWLD did not buy all of the RIFW assets because some whole and part assets were sold separately or retained. Therefore, the values of these assets will need to be deducted from any success fee calculation relating to the portfolio sale transaction. Where part assets have been sold, the sale price is obvious. However, the 'initial appraised value' of the part assets is unclear. Therefore, calculating a 'net value realised' and whether a success fee is payable for these separate disposals is problematic.
- 3.66 Amber and LSH have told us their understanding of how the fee structure operated in practice is that they would receive success fees for asset disposals yielding returns above the 'transfer value.' If their understanding, which has yet to be tested in practice, is correct, this would mean that:
- a existing use values, rather than market values, represented the benchmark for evaluating offers for each asset, including those offering the greatest potential for uplifts in value from subsequent residential development and for which the existing use was agricultural; and
 - b RIFW would pay success fees for all disposals above existing use value, even if a sale was at below market value.

The portfolio sale was not supported by an up-to-date independent valuation against which the buyer's offer could be evaluated

- 3.67 In the absence of an open sale supported by extensive marketing, an independent valuation commissioned by the seller becomes more important. Such an up-to-date valuation provides a seller with guidance during negotiation and a benchmark against which to gain assurance that the best possible price is being obtained. An independent valuation also satisfies the European Commission communication on state aid (OJEC 97/C 209/03) requirement, which specifies that if public authorities intend not to sell land and buildings following a well-publicised, open and unconditional bidding procedure, then an independent valuer should establish the market value (see also [paragraphs 3.130 to 3.137](#)). The RIFW portfolio sale was not supported by an up-to-date independent valuation of the assets, either individually or as a portfolio that would have provided such assurance.

- 3.68 Prior to transferring the properties to RIFW, the Welsh Government had commissioned King Sturge to undertake an independent valuation of the portfolio of potential sites, as at 1 October 2009. The prime purpose of the valuation was to confirm that liquidation of the portfolio would release sufficient cash to meet RIFW's needs, in order to draw down the available EU match-funding for investment in regeneration schemes (see [paragraphs 1.6 to 1.7](#)). King Sturge reaffirmed its valuations in a letter to the Welsh Government, dated 24 March 2010⁵². We consider that the Welsh Government missed the opportunity in October 2009, and again in March 2010, to ask King Sturge for advice on disposal and maximisation of returns, not just simple valuations based mainly upon existing use. Such advice would have provided independent input to the Asset Realisation Plan and also clarified King Sturge's opinions of future value based on changes to planning status and development potential.
- 3.69 In January 2011, LSH reported its opinions of what each of the assets were worth to the RIFW Board in the draft Asset Realisation Plan. We understand that these opinions were based upon updating the King Sturge valuations to take account of differences between the assets as valued by King Sturge and as actually transferred; defects identified up to preparation of the Asset Realisation Plan; changes to planning status; and also market conditions (see [paragraphs 3.59 to 3.61](#)). We are advised that the LSH opinions of value, effectively valuation advice, were not conventional independent market valuations undertaken in accordance with confirmed RICS requirements. LSH does employ valuation specialists who could have undertaken a full RICS valuation; however, they were not involved.
- 3.70 In November 2011, during sale negotiations, LSH obtained a quotation to obtain a full independent valuation of the RIFW portfolio and passed this to Amber. However, the quotation was not taken forward by Amber and its existence was not communicated to the RIFW Board. The absence of an up-to-date independent valuation of public assets prior to a private sale represents a fundamental weakness in the sale process in terms of demonstrating value for money (see also [paragraphs 3.130 to 3.137](#) in relation to state aid).
- 3.71 Following transfer from the Welsh Government to RIFW, deemed to be 10 March 2010, the 18 assets were given a total value of between £20,650,000 and £26,400,000 by King Sturge as at 24 March 2010⁵³. The higher figure included 'hope value'. In the Asset Realisation Plan (presented to the RIFW Board in March 2011, after the initial GST offer and Rightacres expression of interest were received), LSH noted that a portfolio disposal should not be ruled out but proposed a phased disposal of the assets yielding total receipts of £24,935,000 (the 'realisation value'), in their opinion. Both of these figures represent the total of individual asset values rather than a valuation of the portfolio as a single lot. The 'realisation value' excluded any future receipts arising from overage. The Board was not given any information providing valuation advice in relation to a portfolio disposal or on the potential market impact of releasing assets in phases at the times identified in the Asset Realisation Plan.

⁵² King Sturge stated: 'We...confirm that the aggregate market value of the properties is £20,650,000 - £26,400,000, as at 24 March 2010.' The figures excluded properties from their earlier valuation which had not been transferred to RIFW (see Box 7) with the exception of land adjacent to Imperial Courtyard (£100,000). The upper figure included 'hope value' for five sites.

⁵³ In a letter to the Welsh Government dated 24 March 2010. The aggregate values included land adjacent to Imperial Courtyard (£100,000) that was not transferred to RIFW.

3.72 The District Valuer has provided us with valuations of the RIFW portfolio of £32,770,000 at transfer⁵⁴ and £34,339,000 as at the Asset Realisation Plan date⁵⁵, based upon phased disposals and therefore consistent with the preferred approach to disposals in the approved plan.

Competition in the sale process was not encouraged through appropriate marketing and interest in the assets from other potential purchasers was not consistently reported to the RIFW Board

3.73 The ITT information for Investment and Fund Managers set out the Royal Institution of Chartered Surveyors' (RICS) definition of market value as:
'the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arms-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion'.

3.74 RIFW's First Business Plan, approved by the RIFW Board in March 2011, included a section on marketing, to promote the Fund's investment activities and also to support the asset disposal process. The RIFW Board anticipated that the property assets would be marketed for sale after agreeing the First Business Plan which included the Asset Realisation Plan, although these plans did not set out how marketing activity would support the various phased disposal routes that the Asset Realisation Plan proposed. Marketing activities should have been appropriate to the transaction's scale and the numbers of potential buyers; transparent and in accordance with relevant regulations; and involved providing appropriate information.

3.75 In order to maximise potential returns in the difficult and uncertain market conditions which prevailed at the time the Asset Realisation Plan was approved it was important to:

- a adopt an approach to disposal appropriate to each asset; and also
- b market the assets to the widest possible range of potential purchasers.

3.76 The District Valuer's report states:

'There are far fewer potential purchasers who can raise £50 million (especially in the current market) than those that can raise £500,000. The economic law of supply and demand states that where supply remains fixed but demand falls (through reduced competition) then price must also fall. Prudent lotting⁵⁶ and prudent marketing are the counters to this risk.'

'Whilst the assets are virtually all land with some prospect of development, they vary greatly in terms of geographic location, size, end market (residential/ employment), development challenges and time until development realisation. As such, every site has a market of potential buyers but these buyers vary (quite significantly in some instances) from site to site. Again, prudent lotting and prudent marketing are the counters to this risk.'

⁵⁴ 10 March 2010.

⁵⁵ 1 March 2011.

⁵⁶ Either dividing the portfolio into sites grouped by, for example, geographic location or by subdividing large and complex sites into separate lots which can be disposed of at different times and by different methods; in order to maximise sale returns.

3.77 However, the assets were not properly marketed, either individually or as a portfolio because:

- a the initial offer for the portfolio coincided with the process of agreeing the Asset Realisation Plan; and
- b legal title problems and defects associated with the sites delayed preparation of information packs to support marketing.

3.78 The District Valuer's report states that '...a significant divergence exists between our valuations and the sale values achieved. Based on my investigations I believe such a divergence could have been mitigated by a carefully handled disposal process with prudent and proper marketing.' The assets were not openly advertised and no marketing materials were produced or distributed. Wales Audit Office staff conducted a written survey of LSH's marketing contacts and have confirmed that:

- a LSH's activity was reactive, in response to inquiries from interested potential purchasers;
- b interest expressed in buying individual sites was not consistently followed up by LSH; and
- c offers and expressions of interest received by LSH were not consistently and promptly reported to either Amber or the RIFW Board.

3.79 When responding to enquiries, LSH provided the information sheets on the assets that the Welsh Government had prepared prior to the King Sturge valuations, which did not include the King Sturge valuations for each site. An internal LSH email dated 6 April 2011 stated:

'In terms of the portfolio having market exposure, this to date has been fairly limited as we hadn't been gifted with a market instruction and so we have simply responded to inquiries... those who have come forward are by in [sic] large the most active land and property buyers in the local marketplace, so in that regard the exposure has been quite great.'

The meaning of 'the local marketplace' is unclear in this context and could refer to South Wales or to the individual site localities.

3.80 On 21 April 2011, the Portfolio Transaction Report prepared by LSH and Amber informed the RIFW Board that:

'The portfolio has been discussed with a number of investors and developers who are active in the Welsh⁵⁷ market and who form the most likely group of potential portfolio purchasers for assets of this nature.'

Eight developers and investors were listed. The list included Rightacres, whose interest was reported to the Board at the April 2011 Board meeting but did not include GST Investments, whose initial offer had been reported to the Board in March 2011, to whom LSH had provided the information sheets on the assets⁵⁸.

⁵⁷ The draft of this statement prepared by LSH stated 'South Wales market' and was amended by Amber to read 'Welsh market'.

⁵⁸ In early 2011, LSH provided the information sheets to Mr Langley Davies (a Director of SWLD), who represented the purchaser during the sale transaction.

- 3.81 The recommendation to the RIFW Board relating to the proposed sale, prepared by Amber and LSH, dated 5 May 2011 stated that:
'It should be noted that while no formal marketing of the portfolio has been undertaken, LSH consider that all likely potential purchasers have been informally canvassed by them.'

This statement recognised that the portfolio had not been formally marketed, although it suggests that marketing activity had been more extensive than is indicated by the internal LSH email of 6 April. However, the meaning of '... informally canvassed...' in this context is unclear.

- 3.82 On 1 June 2011, Amber summarised Board members' areas of concern about the proposed sale in an email to LSH, querying: 'Is it appropriate to sell the properties now without a formal market test' and noting that 'soft market testing yielded two offers⁵⁹ [sic] only.' A 'RIFW Portfolio Transaction Report – Supplement' dated 2 June 2011 stated: 'The Portfolio has not been openly marketed but has been considered by a number of developers and investors who are active in the Welsh market... The portfolio of properties has not been marketed as a whole and the bids received have been opportunistic, but encouraged, with the majority of parties expressing an interest in the whole portfolio initially showing interest in individual assets and progressing their interest to the whole.'
- 3.83 Offers and expressions of interest from prospective purchasers were not always reported to the RIFW Board and were not dealt with consistently by LSH. On 13 April 2011, LSH received an email from Legat Owen⁶⁰ advising them that one of their clients would be interested in all of the north Wales sites as a single portfolio and requesting a meeting. LSH promptly responded that:
'...it is a little premature at this stage as we still have to collate significant amounts of information'.

We have not found any record of the interest being reported to the RIFW Board and, in contrast, we note that GST Investments were not advised that their own interest in the portfolio, received some five weeks earlier, was premature. In addition, LSH's Manchester Office received an unconditional offer of £2 million for the Bangor site in July 2011, after the terms of the portfolio sale were agreed. This offer was not included in LSH's reports to the RIFW Board. An LSH report to the Board recorded that a company 'has expressed an interest' in the site and in a paper for a meeting with Amber, that LSH met the company in relation to Bangor, Llandudno and Abergele⁶¹.

- 3.84 In December 2012, following the Auditor General's announcement that he would undertake a value-for-money study, Amber provided us with a report containing information from LSH, giving an expanded list of 24 marketing contacts. The expanded list showed that LSH had received specific expressions of interest related to the sites at Rhoose, Brackla, Monmouth and Llantrisant and initial individual offers for the Pyle, Abergele, Llandudno, Brackla, and Cogan Hall sites.

⁵⁹ Only GST Investments made a formal offer for the portfolio.

⁶⁰ Legat Owen had been involved in interim arrangements for managing the RIFW asset portfolio prior to LSH's appointment as Investment Manager.

⁶¹ **Portfolio Transaction Report**, July 2011; and **Management Team Meeting** paper, August 2011.

These expressions of interest had arisen before the submission of the April 2011 Portfolio Transaction Report to the RIFW Board, but were not disclosed within it⁶². RIFW's Investment Manager's Agreement stated that property disposals consistent with the approved Asset Realisation Plan did not require Board decisions. Nevertheless, reports to the Board of expressions of interest and offers should have been both comprehensive and timely.

- 3.85 In April 2011, Amber and LSH jointly staged public-sector-focused events in Llandudno, Merthyr and Swansea in order to market RIFW, targeted at prospective investors rather than potential purchasers of the assets. These events were attended by 52 individuals, and were followed by private-sector events in July 2011 in Swansea and Cardiff and in November 2011 in Conwy, attended by 87 individuals in total. Only one of the 22 presentation slides used at the marketing events mentioned disposal of the assets; the other slides focused on RIFW's core regeneration investment activity. Nevertheless, the events did lead to at least one direct enquiry about the assets. All of these marketing events occurred after the RIFW Board had decided to progress with the GST Investments offer for the portfolio.

Advice to the RIFW Board was unclear and confusing in relation to the merits of approaches from potential buyers when compared with each other and to the value of the portfolio

- 3.86 LSH and Amber jointly prepared a Portfolio Transaction Report to the RIFW Board for a meeting of the RIFW Board members in April 2011. This 'ad hoc' meeting was held over the telephone. Because no minutes were taken there is no formal record of the meeting. The Portfolio Transaction Report compared and evaluated the offer from GST Investments and the initial interest from Rightacres. These were compared against the Welsh Government 'transfer value' of £20,650,000⁶³, rather than the King Sturge upper value including 'hope value,' which if adjusted to match the assets actually transferred to RIFW would be £26,300,000. The Report is inconsistent in the terms used to describe the status of the two approaches from GST Investments and Rightacres, with the terms 'offer', 'bid' and 'proposal' used interchangeably for each, and states: 'In addition to LSH's own valuation, a market comparison is possible through the respective offers from GST and Rightacres'.
- 3.87 This statement was misleading because it created the impression to RIFW Board members that:
- a the approaches from GST Investments and Rightacres were of equivalent status, which they were not (GST Investments had made an offer to purchase, whereas Rightacres had merely submitted an expression of interest in the portfolio);
 - b that LSH's opinion of the total potential receipts from disposal (the 'realisation value') had the status of an independent RICS valuation, which it did not; and

⁶² Interest in relation to Abergele, Llandudno, Cogan Hall, Pyle and Brackla was reported to the Board subsequently.

⁶³ As stated in the **JESSICA Business Plan** and which reflected the King Sturge existing use valuation, which was not the same as the 'transfer value' in the **WEFO Offer Letter** or the **Members Agreement** (£20,627,000).

- c Rightacres' interest and LSH's opinion of value provided a sufficient basis of comparison to provide assurance to the RIFW Board in relation to the adequacy of GST Investments' offer for the portfolio in order to proceed with sale negotiations, when benchmarked against the 'transfer value'.
- 3.88 Rightacres' interest did not constitute a formal offer for the Portfolio, but rather was an enquiry to ascertain whether an offer in the terms proposed would be of interest to RIFW (see also [paragraph 3.42](#)). LSH forwarded Rightacres' expression of interest to Amber on 10 March 2011 and stated that they would contact Rightacres 'and see whether or not I can... get a formal offer from him'. On 11 March 2011, LSH advised Amber that they had arranged to meet Rightacres but expected that Rightacres would undertake a thorough analysis '...before submitting an official bid...'. Although the Rightacres expression of interest was received by LSH on 8 March 2011, it was not reported to the next RIFW Board meeting on 28 March by either LSH or Amber⁶⁴ but was instead reported to the Board in papers for its 28 April meeting⁶⁵. The documents circulated in advance of this meeting included a Portfolio Transaction Report jointly prepared by LSH and Amber comparing the merits of the offer from GST Investments and the expression of interest from Rightacres. However, in making this evaluative comparison, the Portfolio Transaction Report did not make clear to the reader that only GST Investments had actually made an offer. LSH and Amber considered the offer from GST Investments to be the most attractive option and recommended to the Board that RIFW should proceed with it.
- 3.89 A 'RIFW Portfolio Transaction Report – Supplement' dated 2 June 2011, recognised that the portfolio had not been openly marketed and then stated: 'In addition to the interest from GST Investments, the only other party to express an interest in a purchase of the entire portfolio is Rightacres Property Group... The fact that only two interested parties have come forward with either firm interest or indicative proposals is an indication that there is little limited appetite for property assets other than for well secured prime stock.'
- 3.90 LSH's NPV analyses of the Asset Realisation Plan, GST Investments' initial offer and Rightacres' proposals also included an estimation of the income payable to RIFW in the event of overage occurring. However, this overage estimation was restricted to overage on Monmouth based on a sales value of £12.5 million. Whilst this was consistent with the approach to a portfolio sale suggested in the Asset Realisation Plan prepared by LSH, GST Investments' initial offer did not include overage on any of the assets. In contrast, and in addition to overage on the Monmouth site, Rightacres' proposal included overage on the sale of Lisvane, Rhoose, Bridgend and Brackla. An estimation of the potential impact of Rightacres' proposal for overage on these four additional assets was not reflected in the NPV comparative analyses. LSH's evaluation of the two approaches assumed overage protection of the purchaser's interests in uplift over a five-year period. We understand from Rightacres that although they did not specify an overage period in their proposal, they would have considered overage over a longer timescale than five years if they had gone on to make a formal offer for the portfolio.

⁶⁴ Amber asserted to us that the Rightacres interest was tabled at the Board meeting held on 28 March. However, the minutes of the meeting do not make any reference to this.

⁶⁵ The meeting of the Board members on 28 April, held as a telephone conference, was not formally minuted and so the matters discussed at that 'ad hoc' meeting were ratified by the Board at its next formal meeting on 5 May 2011.

Box 9 – Analyses of Net Present Value (NPV)

As well as ambiguity in relation to the status of the two approaches, there were some significant flaws in the financial comparisons of the asset realisation plan, GST Investments' initial offer and Rightacres' proposal, that were reported to the Board in the Portfolio Transaction Report of April 2011. LSH had conducted a series of Net Present Value (NPV) analyses, to provide an 'options appraisal for the disposal of the RIFW portfolio'. These NPV analyses were intended to equalise the present and future value of receipts to RIFW, taking account of factors such as inflation and bank interest. The analyses covered the following scenarios:

- Asset Realisation Plan
- Budgeted Cash flow
- Upside
- Downside
- Sale to Rightacres (with and without overage)
- Sale to GST Investments (with and without overage)

Whilst these NPV analyses appropriately took account of several key cash flow assumptions, they omitted certain cash flows which affected the accuracy of the NPV calculations themselves and also distorted the comparability of the Asset Realisation Plan with GST Investments' initial offer and Rightacres' proposal.

The NPV analyses included:

- An assumed discount rate of eight per cent, to reflect LSH's view of an anticipated return from an investment portfolio of this nature⁶⁶.
- An estimation of the sales costs that reflected the impact of the timing differences between the phased profile of sales within the Asset Realisation Plan and the whole portfolio sales within the GST Investments' offer and Rightacres' proposal.
- The sales income in respect of the Asset Realisation Plan's NPV analysis (this represented the anticipated sales price of each of the assets within the portfolio, whilst for GST Investments' initial offer and Rightacres' proposal this represented the cash payment for the portfolio assets).
- The April 2011 Portfolio Transaction Report, states when comparing GST Investments' offer with the ARP that '...an additional discount of £1.3m has been allowed in order to provide a fair comparison with the GST Proposal'. This discount is unexplained but its impact is to increase the attractiveness of the GST Investments offer when compared with the phased disposal envisaged in the Asset Realisation Plan.
- An assumption that, if successful, the transfer of assets to GST Investments or Rightacres would occur at the same point in time. This assumption ensured that the NPV analysis reflected the impact of the timing differences of the receipt of income for the phased disposal of assets in the Asset Realisation Plan and the whole portfolio sales in GST Investments' initial offer and Rightacres' proposal.

However, the NPV analyses did not reflect the full costs of managing the fund itself or the impact of the sales on these costs. The April 2011 Portfolio Transaction Report notes that, as a result of the sales:

'...the fund will benefit from the security of holding cash as opposed to property and associated liabilities in an uncertain market. Whilst the fund will incur an additional cost of 0.65% Fund Management Fee on these cash deposits, it will benefit from a reduction in the Asset Management Fee of up to 2% of the transfer value as well as proceeds from the idle funds policy of circa 1.75%.'

The differences in the timing of individual asset sales, combined with the differences in the proceeds from sales, would impact on projections for (i) the Fund Management Fee; (ii) the Asset Management Fee; and (iii) the Idle Funds Proceeds. As a result, this omission affected the comparability of the NPV analyses for the Asset Realisation Plan with the NPV analyses of GST Investments' initial offer and Rightacres' proposal.

⁶⁶ A discount rate of eight per cent, which reduces the present day benefit of potential future returns, is typical for a property development business. However, RIFW was involved in regeneration investment, for which a lower discount rate might have been more appropriate. The choice of discount rate is material to comparisons between the GST Investments initial offer, which provided immediate sale receipts and the Rightacres expression of interest, which was more weighted towards receipts from overage over a longer timescale.

3.91 In response to our audit enquiries, we were informed by LSH that their NPV analyses were not intended to be comprehensive. However, the paper prepared by LSH and Amber for the Board at the time did not make this clear. There was scope for the NPV analysis of the GST Investments offer to have been re-performed on a more comprehensive basis at the 'Heads of Terms' agreement stage in June 2011, but we note that this was not done.

The implications of significant changes to the offer during sale negotiations were not clearly reported to the RIFW Board and no robust comparisons of the final sale terms with the Asset Realisation Plan were undertaken

3.92 In February 2012, sale contracts were exchanged and the buyer paid a deposit of £2,174,750. The Board was provided with only a superficial financial analysis of the final sale terms, which did not include a robust comparison with the Asset Realisation Plan, prior to the exchange of contracts. No comparisons with the King Sturge with 'hope value' valuations were undertaken.

3.93 The remaining sale receipts, to the total of £21.747 million, were payable in three instalments over two years, reducing the availability of cash to fund investments which, along with disposal of the less desirable assets, had been presented to the RIFW Board as the key advantages of a portfolio sale. There was no provision in the sale contract for interest to be charged on the instalments, or on receipts arising from overage after they had been triggered⁶⁷. The only provisions for interest in the sale contract were in the event of payment default.

3.94 Amber's recommendation to the RIFW Board relating to the sale and also the Board's resolution were for overage payment deferment periods of three years for the Monmouth site and five years for the Lisvane site⁶⁸, subject to interest charged at four per cent above the base rate. We have not seen any evidence that the Board's attention was drawn to changes in the sale terms relating to interest and deferment. The absence of any provision for inflation uplift or for interest charges in relation to overage payments subject to short deferment periods is not uncommon in property transactions. However, the terms of sale permit SWLD to deduct from the overage payable to RIFW certain of its costs incurred during the period between the sale and the overage payment date, including interest charges on the loan finance provided by GST Investments to SWLD for the purchase.

3.95 The report on the disposal transaction, presented to the Board in May 2011, recommended that the Board should accept the GST Investments offer, which had reduced to £22,000,000 on a 'warts and all' basis. The exact meaning of this phrase during the sale negotiation process is unclear. The phrase appears to have been used in the context of legal title defects and also in relation to development impairments to the assets. It was also used in the context of a portfolio sale including a mix of attractive and less attractive assets. However, we note that during the sale negotiations with GST Investments:

⁶⁷ In the event of an onward sale by SWLD with planning consent in place, overage payments are made to RIFW in line with the payment profile of sale proceeds agreed between SWLD and the buyer.

⁶⁸ **Recommendation to RIFW relating to the proposed sale of the 'Properties' to GST**, dated 5 May 2011; Minutes of a RIFW Board meeting on 6 May 2011; and **Portfolio Transaction Report Supplement**, dated 2 June 2011.

- a assets deemed by the purchaser to be of little or no value were removed from the sale, negating one of the benefits to the seller of a portfolio sale, leaving RIFW in possession of worthless or hard to sell assets;
- b pending completion of full legal due diligence on the assets to determine the extent of defects and impairments, the buyer negotiated a reduction in the sale price and also an agreement for payment by three instalments instead of a cash sale; and
- c LSH, RIFW's legal advisors and the Welsh Government's Commercial Legal Services Department (Legal Services) undertook considerable work to address issues in relation to asset titles and a range of impairments to value prior to the sale.

Box 10 – The initial offer from GST Investments

The initial offer from GST Investments was a cash offer of £23,000,000, but this included land at Wrexham worth £2,060,000 and land adjacent to Imperial Courtyard, Newport worth £100,000 (based on the initial King Sturge valuations), which had not actually transferred to RIFW. The final agreement was for payment of a lesser amount of £21,747,498 in three instalments⁶⁹, taking account of a reduction in the amount the buyer was prepared to pay because of assets being removed from the sale. The RIFW assets removed from the portfolio sale were:

- Anchor Way, Penarth, valued by King Sturge at £100,000, it was removed from the purchase because its value as a 'ransom strip' no longer applied, it is retained by RIFW.
- Garth Park, Talbot Green, valued by King Sturge at £210,000, removed from purchase because its planning status changed to become a 'green wedge' and therefore it had no development potential, it is retained by RIFW.
- Cogan Hall Farm, Penarth, valued by King Sturge at £350,000, removed from the sale because RIFW sold part of the site separately and retained the remainder.
- Part of Brackla Industrial Estate valued at £60,000 was sold separately and so was removed from the portfolio sale. The remainder was sold with the portfolio.

3.96 Sale negotiations between the purchaser and RIFW's advisors were difficult and RIFW's Investment and Fund Managers resisted attempts by the purchaser to reduce the offer price as defects in some of the assets (notably Imperial Park) came to light. The final sale agreement included provision for future payments arising from overage (claw-back) clauses in relation to the Monmouth and Lisvane sites. In order to secure these overage clauses and to ensure Imperial Park's inclusion within the transaction, payment by three instalments (on completion, and on the first and second anniversaries of completion) was agreed. However, the financial implications to RIFW of agreeing to instalment payments without provision for interest on the outstanding payments do not appear to have been brought to the attention of the RIFW Board by its advisors.

⁶⁹ The instalments would have been adjusted if the sale of Brackla had not proceeded.

- 3.97 Following the sale, RIFW's legal advisors prepared a report for RIFW detailing the various legal issues that they had identified and resolved, with assistance from Welsh Government Legal Services and LSH, following the transfer of the assets to RIFW and prior to their sale. These problems had been addressed by measures including correction of deeds and the negotiation of agreements prior to the sale disposal. The purchaser took out indemnity insurance in relation to some remaining legal risks and also took over responsibility for existing leases, rent arrears and building condition defects at Imperial House.
- 3.98 No further financial appraisals or NPV analyses of the subsequent revisions to GST Investments' initial offer or of the final sales agreement were undertaken by LSH for consideration by the RIFW Board. This was despite a number of significant revisions to the initial offer between April 2011 and February 2012. These revisions reflected:
- a the removal of properties (and therefore associated reduction in cash payments by GST Investments for these properties) from the list of assets included in the sale;
 - b payment by three instalments over 24 months without any provision for interest charges;
 - c negotiations regarding inclusion of the sites that were to be covered by overage, the rates of that overage, the length of time to be covered by overage, the payment dates for overage and the application of interest to overage payments; and
 - d other details of the overage provisions including deductible costs.
- 3.99 The amendments to the GST Investments initial offer were reported to the RIFW Board in the subsequent Portfolio Transaction Reports of June 2011, December 2011 and January 2012. These reports included summaries of the revisions to the offer, with explanations of the risks facing RIFW regarding the disposals alongside the uncertainties regarding overage predictions for future revenues. However, the reports highlighted the impacts of these various revisions in cash terms only and did not contain any further NPV analyses. Changes made to the overage clauses in the final sale terms made following the RIFW Board's resolution in May 2011 were not formally reported to the Board (see [paragraph 3.94](#)). As a minimum, it would have been good practice to perform a final NPV analysis and a comparison of the final proposed sale terms with the Asset Realisation Plan. Following the portfolio sale, LSH prepared a revised asset realisation plan, dated March 2012, for the assets excluded from the portfolio sale which were retained by RIFW. The March 2012 Asset Realisation Plan indicated a value of between £50,000 and £100,000 for RIFW's remaining property assets.

3.100 We have conducted our own assessment of the impact on the NPV analysis of removing properties and paying by instalments for each of the iterations of the offer and the final sales agreement, which was for £21.747 million⁷⁰. As shown in Exhibit 8, these changes' overall effect is to reduce to £20.771 million the sales transaction receipts' net present value to RIFW. This figure does not include any potential future receipts arising from the overage clauses on Monmouth and Lisvane. Negotiated changes in the proportions of any uplift which the buyer and seller would be entitled to (the overage percentages) in relation to the Monmouth site were reported to the Board although their impact was not analysed. However, changes to deferment periods between overage being triggered and payment and the provision for interest to be charged, which occurred between the Board's final resolution and the sale contract terms and which affected both sites, were not analysed or reported to the Board. Such an analysis should have been performed in order to enable the Board to evaluate fully the merits of the final sale terms proposed, before agreeing to them.

Exhibit 8 - The impact of changes between the initial offer and the final sale agreement upon the net present value (NPV) of the sale receipts to RIFW

Offer	No of Properties	Properties on which overage is payable	Offer Value £ million	Cash movement from original offer (excluding overage)	Estimated Net Present Value (NPV)	Estimated NPV Movement from original offer (excluding overage)
April 2011	18	0	£23 million	N/A	£23 million	N/A
June 2011	18	2	£22.5 million Payable in three instalments over 24 months	−£0.500 million	£21.416 million	−£1.584 million
December 2011	17	2	£22.19 million Payable in three instalments over 24 months	−£0.810 million	£21.151 million	−£1.849 million
January 2012	15	2	£21.7475 million Payable in three instalments over 24 months	−£1.252 million	£20.771 million	−£2.229 million
Final Sales Agreement – including Brackla	15	2	£21.7475 million Payable in three instalments over 24 months	−£1.252 million	£20.771 million	−£2.229 million

⁷⁰ We have applied a discount rate of eight per cent (as applied by LSH in their NPV analysis) and have excluded sales costs and also income and costs arising from the assets.

Parties involved in executing the sale transaction had relationships with the buyer and the seller that gave rise to potential conflicts of interest

3.101 There were potential conflicts of interest in which two parties involved in the sale had relationships with both the seller and the buyer. We have not seen any evidence that these relationships prejudiced the seller's interests but the management of these potential conflicts did not accord with best practice principles for the proper conduct of public business. In particular, we found that LSH's conflict management handling did not comply with their terms of appointment, relevant professional standards or their own internal procedures.

(i) Lambert Smith Hampton (the RIFW Investment Manager)

3.102 Part of LSH's role as Investment Manager was to manage the assets on RIFW's behalf and also to seek to enhance the property assets' values by promoting sites through the planning process. Immediately following the sale completion of 14 of the assets in March 2012, LSH signed an agreement to act for the purchaser as managing agents in relation to the eight property assets in South Wales, involving handling marketing and sales and including promotion through the planning process. Such an agreement following a sale completion is not unusual in the commercial property sector, as it aids continuity of knowledge. However, at the time LSH entered into the agreement, the Brackla site sale had not been concluded.

3.103 The Investment Manager's Agreement, under which LSH was appointed, states that all conflicts should be notified in advance. In addition, LSH has policies in place to manage potential conflicts for circumstances in which different parts of the company are acting for both sides of a transaction. However, in this instance, the same individual within LSH simultaneously represented both RIFW's interests and also those of the purchaser. We have not seen any evidence of improper conduct or of RIFW's interests being compromised due to the existence of this conflict on the part of LSH. However, this represented a clear and direct conflict of interest which breached the Investment Manager's Agreement, and was in contravention of RICS professional standards and also LSH's own company policies.

3.104 During a RIFW Board meeting on 24 April 2013, which was attended by members of the Wales Audit Office study team as 'observers', LSH presented an update of the progress of the 'pipeline' of prospective regeneration projects. This information included a site in Mumbles. We noted that LSH did not declare any conflicts to the RIFW Board, either during discussion of the specific agenda item or during the standing agenda item on declarations of interest. However, we have since established that LSH had acted for third parties in relation to proposed developments at the Mumbles site.

(ii) Mr Jonathan Geen (a RIFW Board Member)

- 3.105 The RIFW Board approved the First Business Plan, which contained the Asset Realisation Plan on 28 March 2011. At the same Board meeting, RIFW's advisors presented the Board with the offer proposal letter from GST Investments to purchase the whole portfolio, dated 4 March 2011. One of the three independent Board Members, Mr Jonathan Geen, immediately disclosed to the Board the existence of a potential conflict of interest. This was because in his capacity as a solicitor he had previously undertaken work for the potential purchaser and he noted that he might be instructed to act for them in a sale of the RIFW assets. Mr Geen therefore requested that he should not be copied into any RIFW documents or correspondence relating to such a transaction and immediately left the meeting. Subsequently, Mr Geen wrote to the Board Chairman, declaring the potential conflict and he sought, and obtained, the Board's permission to act for the purchaser. At the time of his declaration, Mr Geen had been a Board member since December 2010 and had attended one previous Board meeting, in January 2011.
- 3.106 The RIFW Board's composition and the requirement for RIFW to sell property to realise cash for the Fund increased the potential for conflicts of interest and placed Mr Geen in the difficult position of balancing the responsibilities and duties associated with his unpaid role as a RIFW Board member against his own commercial interests as a solicitor specialising in property law. However, the potential for conflict from asset sales of the Fund was not foreseeable by them because Mr Geen and other Board members were not informed as part of their engagement or initial interviews that asset sales would feature as part of RIFW's early activities. Mr Geen's expectation on taking up his Board membership was that RIFW's focus would be on regeneration investments in areas in which he had few clients, which he did not consider would present any significant potential for conflicts in relation to his legal business.
- 3.107 We note that Mr Geen's role as a Board member did not include providing legal advice to RIFW, which had its own legal advisors. We have not seen any evidence that would indicate any improper conduct by Mr Geen. We also note that information already available to Mr Geen in his capacity as a Board member was not reflected in the purchaser's initial offer.
- 3.108 Mr Geen took no part in RIFW's decisions concerning the sale, the negotiations of the terms of sale or the selection of the purchaser. We have established that Mr Geen did not receive any further information from RIFW relevant to the transaction and that he was either absent from Board meetings altogether, or withdrew from Board discussions where they related to the sale. The GST Investments offer letter of March 2011 expressed the company's intention to complete a sale quickly. At that time, neither party to the transaction was aware of the full extent of defects associated with the assets that would lead to the sale process taking 12 months for 13 assets (completed in March 2012) and two years for Brackla (completed in March 2013), once the conditions of sale had been fulfilled. Therefore, Mr Geen was wholly or partially absent from the Board for much longer than was envisaged in March 2011.

- 3.109 In a separate transaction, completed in November 2011, RIFW sold part of the Cogan Hall, Penarth site for £185,000. In July 2011, Mr Geen disclosed by letter to RIFW that he might act for the purchaser and from that point onwards he was excluded from receiving from RIFW any information relating to the sale.
- 3.110 The Board's small size meant that any member's absence would have a significant impact on the Board's capacity. For this reason, in our view it would have been preferable in hindsight for the Board to have asked Mr Geen to decline to act for the purchasers of RIFW assets, even though he sought and obtained the Board's permission to act for them. Having chosen to act for the purchasers we consider, again with hindsight, that his offer to resign from the RIFW Board should have been accepted and a replacement appointed. Alternatively, another solicitor within Mr Geen's Firm could have acted for the purchasers, subject to appropriate internal safeguards being in place, which would have enabled Mr Geen's continuing participation in the RIFW Board.
- 3.111 Given the limited composition of the Board after Mr Geen's withdrawal, we consider that it would have been an advantage if the Board and Mr Geen had agreed that he would step down permanently to enable another independent member to be appointed in his place, rather than step aside for what turned out to be a near two-year absence. However, we acknowledge that the protracted length of the sale process could not reasonably have been foreseen by any of the parties in spring 2011.

The final sale agreement did not take sufficient account of many of the assets' future development potential, and the land portfolio may well have been sold below its market value

An independent valuation commissioned by the Auditor General indicates that the RIFW property portfolio may have been sold below its market value, but also recognises that RIFW may have lacked the time, means and opportunity to achieve the best possible sale price for the assets

- 3.112 The decisions not to openly market the RIFW properties or to obtain a current valuation of the portfolio at the time of the sale mean that it is not possible to be certain whether the best consideration was obtained from the negotiated sale by private treaty to SWLD. However, the results of professional valuation advice commissioned by the Auditor General from the District Valuer of the entire portfolio (including assets retained by RIFW or sold separately) indicate that the portfolio transaction may have resulted in a sale at substantially below the District Valuer's valuation of its potential market value. It is not possible to be definitive about the exact amount, because this depends upon a range of stated assumptions. However, the District Valuer's report indicates that the difference may be significantly greater than could be expected as a result of subjective valuation assumptions. Certainty will only be established in the event of onward open-market sales of the assets and any potential overage payments to RIFW.

- 3.113 The District Valuer's professional opinion is that the market value of the sale portfolio was just over £9 million above the agreed sale price, excluding any overage⁷¹. However, it is important to note that for the reasons given in paragraphs 3.14 and 3.55, the District Valuer has questioned the extent to which RIFW itself had the time, means and opportunity to have realised the full potential market value. Indeed, we acknowledge that RIFW's structure and remit were not designed to facilitate realisation of the maximum potential sale proceeds from its asset portfolio in the short term.
- 3.114 The District Valuer arrived at a valuation of £30.9 million in respect of the portfolio sold to SWLD for £21.7 million in March 2012, including the Brackla site which completed in March 2013⁷². If the effect of paying the sale proceeds in three instalments is taken into account, the value of the transaction to RIFW falls to £20.771 million. These figures do not include the value to RIFW of any potential future receipts arising from the two overage clauses (for the Lisvane and Monmouth sites) in the event that these clauses are triggered during the specified period following the sale for which they are in place.

Box 11 – Valuations of the RIFW portfolio

The District Valuer's valuation opinion of the portfolio at the time of the sale⁷³ contrasts with the valuations provided by King Sturge prior to transfer from the Welsh Government in October 2009 and March 2010 which were used to identify a 'transfer value' of £20.6 million for the portfolio (which includes assets not transferred to RIFW, sold separately or retained). Reconciling the portfolio totals to take account of these adjustments values the portfolio sold to SWLD at £20,040,000⁷⁴ as an aggregated total, based upon the King Sturge existing use valuations. This figure does not include any adjustments for impairments which came to light subsequently, for 'hope value', for a portfolio discount or arising from the inclusion of overage clauses. If the King Sturge with 'hope value', reflecting market value figures are included, the King Sturge aggregated market valuation of assets sold to SWLD is £25,580,000, which does not include a portfolio discount, any adjustments arising from the inclusion of overage clauses or any potential overage receipts.

In December 2011, during the sale negotiations the purchaser, SWLD instructed Savills to value the portfolio. Subsequently, SWLD offered to provide us with this valuation to assist our audit work. In January 2012, Savills valued the assets at between £22.3 million and £25.6 million, including sites which were not subsequently sold to SWLD. If these are removed, the Savills valuation is between £22.2 million and £25.4 million. Savills suggested a 20 per cent discount should be applied to the total value of the assets for a portfolio sale, valuing the sale at between £17.7 million and £20.3 million. Both SWLD and LSH have stated to us their strong belief that the Savills valuation demonstrates that the sale represented good value for RIFW.

71 The District Valuer's valuation of the assets is based upon an open sale of the portfolio, supported by proper marketing, between a willing seller and willing buyer, in which both parties acted knowledgeably, prudently and without compulsion.

72 The sale price achieved for the Brackla site within the portfolio sale, of £6,018,029, was in line with the District Valuer's valuation of the site. It also exceeded the King Sturge market valuation of £5,440,000 and which included part of the site which was sold separately for £600,000.

73 Completed in March 2012 with the exception of Brackla; completed in March 2013.

74 Based on aggregating individual King Sturge valuations of assets sold to SWLD. A total calculated by deducting King Sturge valuations of assets not included in the SWLD sale as at October 2009 and the sale price of the part of Brackla sold separately in November 2011 from the 'transfer value' (excluding the land adjacent to Imperial Courtyard not transferred to RIFW) which reflected existing use, as at March 2010, is £19,830,000. However, this method is less accurate because the 'transfer value' did not represent the aggregated individual values of the assets (based on existing use) and also the values of the Garth Park Talbot Green and Anchor Way Penarth assets, excluded from the sale, had fallen since the King Sturge valuation.

Box 11 – Valuations of the RIFW portfolio (continued)

In October 2013, the RIFW Board commissioned a valuation report from Colliers International LLP (Colliers), reported in February 2014. Colliers valued the assets sold to SWLD at £19,400,000 at the time of sale, taking into account the sale of the assets as a portfolio with the inclusion of overage provisions for the Lisvane and Monmouth sites⁷⁵. The RIFW Board has stated to us its strong belief that the Colliers valuation demonstrates that the sale represented good value for RIFW.

The District Valuer has examined the various valuation reports of the portfolio detailed above (by King Sturge, Savills and Colliers) and has reviewed and commented upon the assumptions that underpin each of these valuations in its Report to the Auditor General. The individual assets' valuations and a valuation of the assets sold to SWLD as a portfolio sale are set out in [Appendix 3](#). The table identifies where valuations are made upon different bases, such as existing use or market value and also where different assumptions are made, such as inclusion or not of overage clauses (which normally result in the purchaser negotiating a lower sale price).

Differences in the values attributed to the Lisvane site account for a significant proportion of the variation between valuations of the whole portfolio sold to SWLD performed by the District Valuer, Savills and Colliers. The District Valuer's valuation of Lisvane assumes that to maximise potential returns, the site is prudently lotted and not sold as part of a portfolio. The District Valuer's market value of the whole Lisvane site is £10.50 million, compared with Savills' upper value of £4.00 million and Colliers' valuation of £2.26 million. For a site such as Lisvane, currently in agricultural use, the likelihood of future residential development has a significant impact upon market value. Colliers' view as at their valuation date (February 2012) is that '...an allocation for development was unlikely to be forthcoming within at least ten years.'⁷⁶ However, the District Valuer's assessment of the likelihood of residential development (as at March 2012) is more optimistic because the City of Cardiff Council's Cabinet withdrew its draft Local Development Plan in October 2010 due to a lack of identified green-field development. This increased the likelihood of residential development on the Lisvane site within the timescale of the current Local Development Plan cycle, to autumn 2015.

In addition, Colliers base their valuations on assumptions stated in their valuation report that:

- The King Sturge existing use valuations, without 'hope value,' which informed the 'transfer value' represented the individual assets' market values and also that of the portfolio.
- There were two bidders and the sale '...process produced two willing and able purchasers in a competitive process', thereby giving a clear indication of the portfolio's market value.
- The market appetite 'for the lower value properties such as many of those in North Wales' is limited and SWLD was subsequently unable to sell the Wrexham, Llantrisant, Towyn and St Asaph sites at auction'.
- 'Whilst the Properties could have been more widely marketed, by say a campaign in the Estates Gazette, ...it could serve to deter many bidders because they may decide not to allocate resources to engage in the assessment of the properties before bidding.'

⁷⁵ Colliers used the exchange of sale contracts date (February 2012) for valuation purposes.

⁷⁶ Colliers International; **Regeneration Investment Fund for Wales LLP, Freehold Properties in South and North Wales:** January 2014.

Box 11 – Valuations of the RIFW portfolio (continued)

- The sale process, a portfolio sale by private treaty, was appropriate and effective and although subdividing the portfolio into lots may have mitigated the portfolio discount (compared with the aggregate total of individual valuations), there was no obvious breakdown and disposal ‘...as a single package forced bidders to take the rough with the smooth’.

However, our study findings have established that in relation to the portfolio sale:

- The ‘transfer value’ based upon King Sturge valuations of the assets’ existing use did not reflect market value. The King Sturge aggregated with ‘hope value’ market valuation of assets sold to SWLD is £25,580,000 (not including a portfolio discount or any adjustments arising from the inclusion of overage clauses).
- There was only one offer for the portfolio.
- The statement that SWLD were unable to sell sites at auction is incorrect. We have established that the sites were not offered at auction and then withdrawn. Furthermore, there was market interest for the sites in North Wales, including two expressions of interest for several sites as a single lot and also two initial offers for individual sites.
- A sale of public assets by private treaty in the absence of either open marketing or an independent valuation is problematic in terms of demonstrating value for money and also demonstrating compliance with EC requirements in relation to state aid.
- The final terms of the portfolio transaction included the assets with the greatest development potential but left RIFW holding hard-to-sell or low-value assets.

Savills’ valuation report, produced for SWLD, dated January 2012, states that developable land at Lisvane, with planning consent could be worth in the region of £2 million per acre (excluding infrastructure and the impact of any affordable housing provision). However, the entire site is not developable. Valuers apply assumptions to developable areas and then discounts for the presence of overage, planning risk and to reflect other issues, such as the costs of providing access, infrastructure and public amenities. We are advised by the District Valuer that differences between the District Valuer’s valuation approach and that of Colliers relate to such discounts and also to other development factors which contribute significantly to differences between the District Valuer’s and Colliers’ final valuations. The District Valuer advises us that its more conservative approach to discounting is more appropriate.

Overall, in relation to the valuations from Savills and Colliers, the District Valuer’s professional judgement is that its assumptions are reasonable and that its own, higher, valuations are robust. Rightly, LSH identified that there are difficulties associated with providing market valuations for the RIFW asset portfolio because for the most attractive sites there was no comparable information available from similar sales:

‘...to the best of our knowledge a site of 121 acres (total 568 acres) has never before been sold for residential development in Wales nor has a site of 20+ acres in Monmouth, with the latter’s new house provision being catered for by smaller development of windfall sites over the past plan period’⁷⁷.

⁷⁷ Included in an email from Amber dated 9 June 2011.

3.115 Having considered these issues carefully, we have concluded that, due to flaws in the way RIFW was established, in the selection of assets and also in the sale process itself, neither RIFW nor the Welsh Government are able to demonstrate that value for money was achieved from the portfolio sale transaction. Our conclusion is reinforced by, but is not completely dependent upon, valuation advice provided by the District Valuer. Even if the District Valuer had concurred with the actual sale price achieved, our overall conclusions would remain unchanged.

Box 12 – Other RIFW asset disposals

In addition to the portfolio sale to SWLD, RIFW sold parts of individual sites separately. These were:

- Part of Cogan Hall Farm, Penarth, given a value of £50,000 by LSH was sold for £185,000, RIFW retained the remainder. The District Valuer has provided a valuation for the whole site as at March 2012 of £200,000.
- Part of Brackla Industrial Estate given a value of £60,000 by LSH was sold for £60,000⁷⁸.

Comparison of the sale prices with the District Valuer's valuations does not therefore indicate that these two assets were sold below value, although we note that the sale contracts did not include any provision for RIFW to benefit from any future uplifts in value through overage clauses.

3.116 During the course of our study, the Welsh Government also commissioned an independent peer review of the professional advice received by the RIFW Board in relation to the disposal of the asset portfolio, conducted by Deloitte and reported in August 2013. We note that the Deloitte report made various observations in relation to the professional advice provided to the RIFW Board which are similar to those which we identified in our study. We comment further on the Deloitte review in [paragraphs 2.36 to 2.38](#) and [paragraphs 4.13 and 4.20](#) of this report.

The sale agreement did not provide sufficiently for the seller, RIFW, to benefit from increases in the value of assets which offered potential for development

3.117 Several of the assets transferred to RIFW offered potential for significant uplift in value if their planning status were to change (for example, from agricultural to residential use because of a site's inclusion for development in a Local Authority's Local Development Plan, or in the event of planning permission being granted for residential development). In particular, the King Sturge valuation reports⁷⁹ identified that some sites had 'hope value' above their existing use value and also, if sold, should be protected by 'overage clauses' which would provide additional revenue to the seller in the event of changes in status that triggered those clauses. The seven sites that King Sturge identified as having potential for future uplift in their value were:

- Lisvane

⁷⁸ The remainder was sold to SWLD with the portfolio for £6 million. The District Valuer has provided a valuation of the part sold to SWLD (as at March 2013) that matches the sale price.

⁷⁹ Comprising a valuation report covering sites identified for transfer to RIFW but not Brackla and a separate valuation report for Brackla; with values as at 1 October 2009. In March 2010, King Sturge reaffirmed its individual valuations for the assets transferred to RIFW (but including land adjacent to Imperial Courtyard which was not transferred).

- Monmouth
- Towyn
- Pyle
- St Asaph
- Abergele
- Brackla⁸⁰

3.118 We note that whilst the original King Sturge valuation report was provided to both Amber and LSH by the Welsh Government, copies were not provided to the RIFW Board members themselves. This meant that the Board members were largely unaware of how the valuation information had been used to determine the 'transfer value' of the assets.

3.119 In March 2010, the Welsh Government's Estates and Projects Division reviewed the King Sturge valuations for WEFO. Their report letter identified that within the mixed portfolio of sites selected for RIFW, some sites offered potential for increased value whereas others were suitable for quick disposal to realise cash for the Fund. The letter reporting the review conclusions stated that overage protection would not be required for the transfer from Welsh Government to RIFW; but, onward sales '...of sites which have not been fully tested (in terms of maximising value) would necessitate such a claw-back (overage) clause'. We have seen no evidence that this letter was provided by the Welsh Government to RIFW or its advisors.

3.120 The sale of 14 assets was completed on 2 March 2012 for £15.7 million and for the final site, Brackla on 1 March 2013 for £6 million once the conditions of sale, which related to planning, had been fulfilled. Only the Monmouth and Lisvane assets were subject to overage clauses entitling the Welsh Government to a percentage share of future profits, subject to certain contractual conditions, if the value of the assets increases within a specified period following the sale. The baseline figures stated in the sale contract for the calculation of overage are the values ascribed to the two sites within the portfolio sale price of £21.745 million (see [Appendix 3](#)). These figures are the same as the King Sturge valuations of the sites based upon existing use as at October 2009 and March 2010. If the clauses in respect of those two sites are triggered, then any receipts arising from increases in value will provide a further return to the public purse. The likely amounts involved are difficult to estimate in advance, although LSH advised RIFW that the total additional payments to RIFW arising from the overage clauses in relation to the two sites could be £10.9 million. The District Valuer has also provided indicative estimates of potential 'claw-back' overage payments of £11.3 million for Lisvane and £9.4 million for Monmouth, based on 2013 land values.

⁸⁰ King Sturge identified the Monmouth and Brackla assets as having potential for future uplift that should be protected by overage if sold, but did not assign 'hope value' to them.

- 3.121 The District Valuer has advised us that 'claw-back' overage clauses could also have been considered for nearly all of the sites, not just for Lisvane and Monmouth, and particularly for the Aberdare, Bangor, Rhoose, Pyle and Brackla sites, where planning consent for some residential development has been secured subsequent to the sale by RIFW, or onward sale has provided profits to SWLD. It is important to note that although selling an asset with potential for uplift subject to a 'claw-back' overage clause can provide some protection to the seller and provide additional returns from a share of the uplift, including such a clause generally, though not always, results in the buyer negotiating a lower sale price.
- 3.122 The RIFW Asset Realisation Plan suggested overage provisions in relation to the Lisvane, Monmouth, and Towyn properties as well as the retained portion of Cogan Hall, Penarth but did not suggest overage for all of the properties for which planning status had already improved since transfer; which therefore, had increased potential for future returns. The Asset Realisation Plan did not suggest overage for Pyle, St Asaph or Abergele although these sites were identified as having 'hope value' by King Sturge. In addition, the Asset Realisation Plan did not suggest overage for Brackla, although King Sturge identified that if sold, overage should be included in the sale contract. The Asset Specific Business Plans identified that there were opportunities to promote sites through the planning process. However, apart from where overage was proposed, it is not clear whether LSH's 'realisable values' assumed that planning permission would be in place prior to disposal. The RIFW Business Plan did not include any consideration of how overage provisions may benefit the Fund beyond the period determined by the match-funding requirement, to December 2015.
- 3.123 The Portfolio Transaction Report of April 2011 prepared by LSH and Amber, which included analysis of the GST offer and the Rightacres proposal, set out a range of considerations in relation to the property market and wider economy relevant to a decision to dispose of the assets either in a single transaction or via individual sales, as proposed in the Asset Realisation Plan. The Transaction Report identified that the Monmouth site had the greatest realistic overage potential within a portfolio sale, but that the sites at Lisvane, Rhoose, Pyle, Brackla and Bangor also offered overage potential if sold individually. The Report indicated that a wider application of overage to sites within a portfolio sale would result in a purchaser negotiating a lower cash price; reducing the availability of funds for RIFW's investments. Although LSH identified that inclusion of overage may result in a purchaser negotiating a lower sale price, this was not explored with the actual purchaser during negotiations⁸¹. Similarly, the impacts of different potential approaches to overage (including the implications of different overage periods) upon present, future and total sale receipts were not considered by LSH and reported to the RIFW Board. The Rightacres proposal, which included overage in relation to Lisvane, Monmouth, Rhoose, Pyle and Brackla sites; was for a lower initial cash amount than the GST Investments initial offer, which did not include overage on any of the sites.

⁸¹ During the sale negotiations the purchaser commissioned a valuation report from Savills which identified particular potential for uplifts in value for the Lisvane, Monmouth, Rhoose and Brackla sites, together with downside risks for the Imperial Park site.

- 3.124 During the sale negotiations, overage was requested at Amber's instigation. Initial discussions regarding overage were only in relation to Monmouth, because the site was felt to offer the greatest short-term potential for a change in planning status. Subsequently, overage was also requested by Amber in relation to Lisvane. It is not clear why overage was not requested in relation to other sites with development potential, such as Rhoose, Pyle and Brackla, (the sale of the Brackla site was itself conditional upon planning issues being resolved before completion, which would inevitably enhance the site's value to the purchaser). Although the RIFW Business Plan focused upon a three-year period, as required by the fund and investment managers' agreements, consideration should have been given to the Fund's longer-term income and of opportunities to maximise returns from assets if these extended beyond December 2015. However, the information provided to the RIFW Board by its advisors and the Business Plan agreed by the Board, clearly prioritised provision of short-term cash to the Fund, to December 2015, over longer-term maximisation of returns.
- 3.125 The land disposal coincided with changes to new Local Development Plans being produced by local authorities. This was particularly significant for the Lisvane property which forms part of a larger North East Cardiff Consortium site. For a number of years prior to the King Sturge valuation in 2009, this Consortium site had been advanced as a site for development during the consultation process for developing Local Development Plan proposals. In March 2010, the City of Cardiff Council withdrew its draft Local Development Plan following a critical Planning Inspector's report. The Inspector highlighted that the Council was over-reliant on brown-field sites for development. This decision increased the likelihood of green-field site development in North Cardiff and particularly in Lisvane. Importantly, however, the increased likelihood of Local Development Plan inclusion and subsequent planning permission for residential development, with resulting significant uplift in value, was not reflected in the Asset Realisation Plan approved by the RIFW Board in March 2011.
- 3.126 In October 2012 the City of Cardiff Council published its preferred Local Development Plan Strategy 2006-2026. The preferred strategy includes significant housing development in the Lisvane area of Cardiff. The deposit Local Development Plan for Cardiff was agreed by Cabinet for public consultation in September 2013 with a timetable for final adoption of autumn 2015. The Local Development Plan was approved at a full meeting of the City of Cardiff Council on 26 June 2014 for submission to the Welsh Government for independent examination. The Lisvane properties sold by RIFW are included in the Plan amongst land west of Pontprennau, earmarked for between 4,500 and 6,000 new homes. A speculative application for planning permission for residential development on the Lisvane site had already been submitted to the Council (the 'Churchlands' development) by SWLD, in advance of the Council finalising its Local Development Plan. In January 2015, the City of Cardiff Council refused planning consent. SWLD lodged an appeal to this decision but the appeal is unlikely to be decided before Cardiff's Local Development Plan is adopted, estimated to be in September 2015.

- 3.127 Land purchased by SWLD in Monmouth and Bridgend has also been included in deposit local authority Local Development Plans since the sale. The District Valuer's report identifies all of the assets' current development value. The District Valuer informed us that where land is allocated for development it is likely to substantially increase the value of that land. King Sturge valued the 120 acres of RIFW land at Lisvane, Cardiff at an agricultural use value of just over £15,000 per acre. In addition, King Sturge noted that should this land be allocated for development, receive planning consent and with servicing and infrastructure works completed, then it could be worth in the region of £1,000,000 per acre. This figure has been widely reported in the media, however, not all of the site can be developed. The various estimates of the site's developable area made by Colliers, Savills, SWLD (in its planning application for 1,200 dwellings) and the District Valuer all range between 58 per cent and 63 per cent.
- 3.128 We note that in an email response to a query from a Board member dated 9 June 2011, which was copied to the Chair of the RIFW Board, Amber provided LSH's estimates of value with Local Development Plan inclusion of £18.0 million for the Lisvane asset and £13.8 million for the Monmouth asset⁸². LSH stressed the difficulty in seeking to assess potential future values for overage purposes, noting that:
- 'As previously stated without detailed site infrastructure, environmental, ground and other related costs, detailed planning information, social housing and s106 provision requirements and assurances of developer demand, it is virtually impossible to place an accurate site value on the land. The best we can do is make broad brush assumptions based upon smaller sites which have been sold historically using our knowledge of the market to provide a best estimate of where values may lie.'
- 3.129 Since the sale transaction, SWLD has sold on four of the sites; the former Mayhew Foods site at Aberdare and the site in Bangor, both in July 2012; part of the Pyle site in January 2014 and Monmouth in April 2015. RIFW had a legal charge over the assets covering the agreement within the sale contract with SWLD for staged payments. Therefore, until March 2014, when the final payment was made, SWLD was required to notify RIFW of any sales in order for the legal charge to be lifted in relation to the relevant sites. SWLD sold Aberdare for £430,000, Bangor for £2.5 million and seven acres of the 13-acre Pyle site for £2 million (less consequential costs for SWLD of between £350,000 and £500,000). The sale price achieved by SWLD for Aberdare accords with the District Valuer's valuation, the price achieved for the part-sale of the Pyle site is considerably above the District Valuer's valuation of £450,000⁸³ for the entire Pyle site, but the sale price for Bangor agreed between SWLD and their purchaser is £900,000 less than the District Valuer's valuation of £3.4 million⁸⁴. The Monmouth site was sold with planning consent in place and so was sold for a sum significantly above the District Valuer's valuation, which was without planning consent.

⁸² These estimates of potential value and overage yields for the Monmouth and Lisvane assets were also included in a **RIFW Portfolio Transaction Report – Supplement**; dated 2 June 2011.

⁸³ Planning consent for residential development at Pyle has been granted since the District Valuer Services' valuation, as at March 2012, increasing the site's value. A valuation commissioned during sale negotiations by the purchaser from Savills, valued the Pyle site, with planning permission in place, at £2 million. The District Valuer Services' valuation as at May 2013 is £2.1 million.

⁸⁴ We do not know whether onward sales by SWLD are accompanied by any agreements that would provide future returns to the seller in addition to the sale price, and which may influence the sale price.

The sale gives rise to potential state-aid considerations

3.130 Risks in relation to providing a 'state aid' were recognised by the Welsh Government and RIFW, including its advisors, in relation to RIFW's investment activity but were not identified in relation to asset disposals. The sale of public assets at a value less than their market value may constitute a type of anti-competitive 'state aid' which is, if certain conditions are met, prohibited by the Treaty on the Functioning of the European Union and is therefore unlawful. The potential aid element is the effective subsidy provided by the selling body to the purchaser, and is therefore valued as the difference between the actual sale price and market value.

Box 13 – State aid considerations

The European Commission's **Communication on State aid elements in sales of land and buildings by public authorities** (97/C 209/03) sets out two methods by which 'market value' can properly be determined:

- the first method is a sufficiently well-publicised, open and unconditional bidding procedure; and
- the second method is by commissioning a professional valuation from a qualified valuer.

If neither of these methods is followed, the Communication requires that Member States investigate whether it appears that unlawful state aid was provided and, if so, then notify the transaction to the European Commission.

The European Commission's Communication applies only to sales of publicly owned land and buildings. Therefore, the Communication applies to RIFW's sales of assets but not to the transfer of assets to RIFW from the Welsh Government. It states:

'A sale of land and buildings following a sufficiently well-publicized, open and unconditional bidding procedure, comparable to an auction, accepting the best or only bid is by definition at market value and consequently does not contain state aid. The fact that a different valuation of the land and buildings existed prior to the bidding procedure, e.g. for accounting purposes or to provide a proposed initial minimum bid, is irrelevant.

'An offer is 'sufficiently well-publicized' when it is repeatedly advertised over a reasonably long period (two months or more) in the national press, estates gazette or other appropriate publication and through real-estate agents addressing a broad range of potential buyers, so that it can come to the notice of all potential buyers.

'The intended sale of land and buildings, which in view of their high value or other features may attract investors operating on a Europe-wide or international scale, should be announced in publications which have a regular international circulation.

'If public authorities intend not to use the procedure described...[above] an independent evaluation should be carried out by one or more independent asset valuers prior to the sale negotiations in order to establish the market value on the basis of generally accepted market indicators and valuation standards.'

3.131 In February 2013, Amber obtained, on RIFW's behalf, a legal opinion in relation to state aid from RIFW's own legal advisors. Their opinion was that the EC Communication had been complied with because:

- a '...the portfolio sale was carried out in a transparent way with full market awareness involving major market players.';
- b Rightacres made an offer to buy the portfolio which facilitated a fair comparison of the options available;
- c LSH's opinions of value in the Asset Realisation Plan '...followed initial market exposure, allowing LSH to assess commercial interest in the portfolio.'; and
- d 'An independent and reputable asset valuer was procured and a proper evaluation of market value was conducted, allowing a fair assessment of the options available to RIFW.'

3.132 In February 2014, Amber also sought (at its own expense) Queen's Counsel (QC) opinion on a range of state-aid matters in connection with the RIFW asset disposal. Amber provided Wales Audit Office staff with a copy of the QC opinion in January 2015. The QC was asked by Amber to provide an opinion on the following:

- a could the transaction comprise a breach of state-aid rules by RIFW;
- b the applicability of the European Commission circular 97/C 209/03 to the transaction and, if so whether the land disposal process adopted by RIFW complied with the 'sale without unconditional bidding procedure' set out in the circular;
- c the relevance of the actual price obtained in this sale transaction to any unlawful state-aid issues if RIFW believed the price was at over market value, had acted on professional advice and has legal recourse against an external valuer in the event that sale at under value is subsequently shown to have occurred;
- d the state of mind of RIFW at the time of the disposal could be relevant to any consideration of the possibility of giving inadvertent unlawful state aid; and
- e the reliance of RIFW on external professional advice is relevant to any consideration of possible state-aid issues.

3.133 The QC concluded that the sale process followed by RIFW did not involve an unconditional bidding procedure and therefore the sole material consideration in relation to compliance with the EC Communication on state aid was whether an independent valuation to accepted standards had been obtained. The QC's opinion was: 'I can find no indication that a State aid was granted. The suggestion that the Communication was not complied with is dubious.' Importantly, however, this opinion was based upon assumptions that:

- a there was active marketing before and after RIFW's decision to proceed with the sale;
- b the sale price exceeded the 'existing book value' and that this 'reflected the then perceived market value of the assets in question';
- c a normally prudent and diligent private-sector operator would have been unable to agree a sale on better terms than those which were achieved;
- d LSH's opinions of value in the Asset Realisation Plan were sufficiently independent to satisfy the requirements of the EC Communication and this independence was not compromised by the success fee arrangements set out in the Investment Management Agreement or by LSH agreeing to act for the purchaser; and
- e formal compliance with the EC Communication requirement that a valuation is carried out on the basis of generally accepted valuation standards would not 'be relevant to a normally prudent and diligent private sector landowner'.

3.134 The QC also gave opinions that:

- a the vendor's beliefs in relation to the sale price achieved are not relevant to determining whether a state aid occurred; and
- b whether the vendor acted upon professional advice and has any legal redress in the event of a sale at under value are not considerations relevant to determining whether a state aid occurred.

3.135 In light of our study findings, we are unable to place audit reliance upon either the legal opinion obtained by RIFW or the QC opinion obtained by Amber in relation to the potential provision of a state aid. This is because our study has established that in relation to the portfolio sale:

- a there was no open and unconditional bidding procedure and there was only one offer for the portfolio;
- b the assets were not advertised nationally or internationally, either individually or as a portfolio;
- c the assets were not openly marketed either individually or as a portfolio and LSH's 'informally canvassed' and 'soft market testing' activity was reactive and focused only upon the Welsh property market;
- d LSH's own opinions of value in the Asset Realisation Plan were not based upon a valuation conducted to RICS standards;
- e LSH were responsible for marketing the assets, providing advice to the RIFW Board in relation to the sale process, recommending acceptance of the offer and also benefitted from a success fee; and so did not meet the RICS requirement of independence when providing its own opinions of value to RIFW;

- f LSH's agreement to act for the purchaser before the sale of all of the assets was completed and failure to manage the resulting conflict of interest appropriately, further compromised their independence per RICS requirements; and
- g although LSH themselves did obtain a quotation for an independent valuation to RICS standards, such a valuation was not undertaken before the sale.

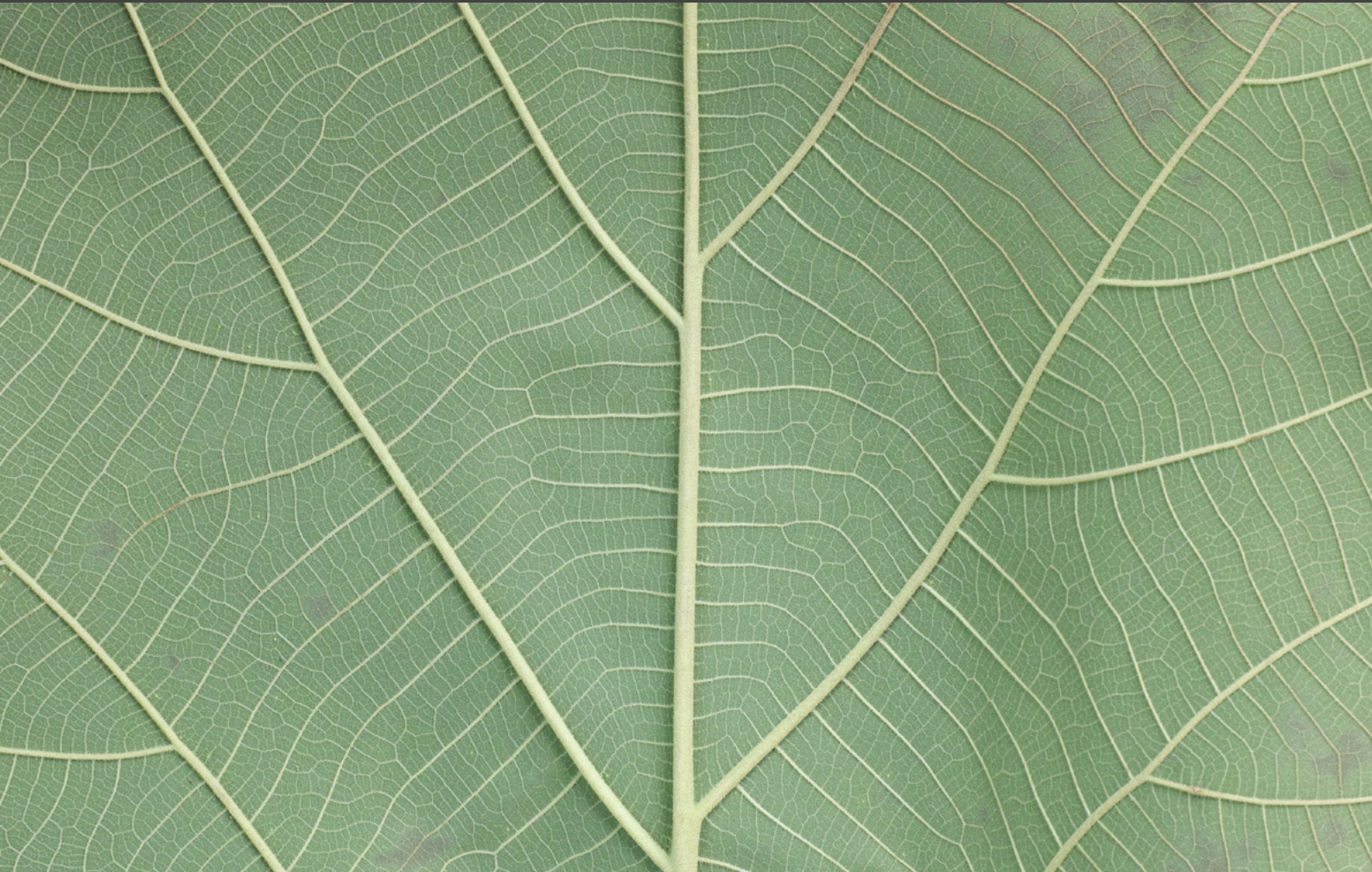
3.136 Although there is a difference between failing to maximize returns to the public purse and providing unlawful state aid, the absence of both an open bidding procedure (see [paragraphs 3.73 to 3.85](#)) and a professional valuation (see [paragraphs 3.67 to 3.72](#)) could mean that the transaction includes an element of unlawful state aid; particularly if there is evidence that the assets were indeed sold below market value. The valuation by the District Valuer (as well as the earlier King Sturge with 'hope value' valuations) suggests that the assets may have been sold at below market value⁸⁵. In addition, payment of the sale proceeds by interest-free instalments may comprise a commercial subsidy to the purchaser.

3.137 Taking all of these matters together, we consider that the sale may give rise to potential state-aid considerations, and that the Welsh Government should investigate whether unlawful state aid has been provided and discuss with the UK Government whether the transaction should be notified to the European Commission by the UK Government.

⁸⁵ See Appendix 4.

Part 4

Overall, the actions that the Welsh Government and WEFO have taken in response to the developing concerns about RIFW have been appropriate



Part 4 - Overall, the actions that the Welsh Government and WEFO have taken in response to the developing concerns about RIFW have been appropriate

The Welsh Government's response to an Assembly Question about RIFW did not challenge the version of events put forward by the Board and the Fund Manager

- 4.1 On 21 March 2012, Mr Byron Davies AM tabled a Written Assembly Question on RIFW to Mr Huw Lewis, the then Minister for Housing, Regeneration and Heritage. The Written Assembly Question focused on the public land and property assets transferred to RIFW and their disposal. This was the first occasion when concerns were raised publicly concerning the sale of RIFW assets.
- 4.2 The Minister's response to the Written Assembly Question stated that:
- a LSH had actively canvassed potential purchasers for the land portfolio;
 - b that the sale value was in excess of an independent market valuation; and
 - c that the land assets were sold as a portfolio to avoid potential bidders picking the best sites leaving the less desirable ones unsold.

This response was prepared by Welsh Government officials based on information provided to them by Amber and the RIFW Board. Welsh Government officials did not seek to validate these assertions before providing advice to the Minister.

After concerns were raised by an Assembly Member in March 2012 about the sale of RIFW assets, the Auditor General made some preliminary enquiries

- 4.3 On 27 March 2012, the Auditor General received correspondence from Mr Byron Davies AM expressing concerns regarding the sale of RIFW land, and his dissatisfaction with the Minister's reply to his Written Assembly Question. There were three main concerns raised by Mr Davies:
- a the sale was by private treaty, rather than an open market sale;
 - b the role of LSH in the sale of the properties; and
 - c whether the sale represented value for money considering the potential increase in the value of the land once any planning consent was obtained.
- 4.4 On behalf of the Auditor General, staff of the Wales Audit Office met Mr Davies on 3 April 2012 to discuss his concerns. At a subsequent meeting, a member of Mr Davies' staff informed us that he was aware of individuals who would have been interested in purchasing some of the land in both Cardiff and the Vale of Glamorgan, but who had apparently been unable to make an offer because the assets they were interested in were not offered openly for sale.

- 4.5 In order for the Auditor General to respond appropriately to the issues raised by Mr Davies, we made several preliminary enquiries. These included:
- a clarifying the nature of RIFW and its relationship with the Welsh Government;
 - b obtaining documentation from Amber, which is responsible for exercising RIFW's executive functions and implemented the RIFW Board's decisions regarding the asset portfolio sale; and
 - c undertaking initial company and media searches regarding all parties involved in the land transaction.
- 4.6 Our initial enquiries did not provide sufficient assurance regarding the governance, propriety and value for money of the land sale. These enquiries instead raised a number of additional questions and audit risks in relation to the transaction, and the Auditor General determined the need to conduct a value for money study into RIFW. In light of the identified audit risks, in September 2012, staff of the Wales Audit Office, acting on behalf of the Auditor General, contacted South Wales Police to inform them of the initial audit findings.
- 4.7 As at the publication date of this report, the Auditor General has been informed by the Serious Fraud Office, that having taken time and given careful consideration to the information available pertaining to RIFW, they have concluded that this is not a matter which falls within their remit for investigation. Should further information come to the attention of the Serious Fraud Office or South Wales Police, the matter may be reviewed.

The actions the Welsh Government and WEFO have taken since October 2012 in response to the developing concerns about RIFW have, in our view, been appropriate

In October 2012 the Auditor General's initial review of RIFW was widened to a value for money study and the Welsh Government announced an internal suspension of the Fund's activities

- 4.8 On 27 September 2012, the Auditor General wrote to Mr Davies to inform him that the scope of his audit review was being widened. In a second letter to Mr Davies on 26 October 2012, the Auditor General explained his intention to conduct a value for money study that would not just focus on the sale transaction itself but would also:
- a examine the aims, governance and operation of RIFW, including its ongoing business; and
 - b consider the effectiveness of the Welsh Government's oversight arrangements for RIFW.

- 4.9 Given the widened scope of the review and whilst the Auditor General's study fieldwork was still ongoing, the Welsh Government took appropriate action to pause RIFW's operations. In October 2012, Welsh Government officials suspended all RIFW business, including investments and any further asset disposals. This decision was not publicly announced at the time, but was taken to seek to protect the public purse from any further potential financial risk whilst our value-for-money study fieldwork was being performed.
- 4.10 Since October 2012, the actions taken by the Welsh Government in handling the concerns about RIFW have been reasonable. The Welsh Government's handling of this matter from October 2012 onwards was affected, as senior officials were made aware (in strict confidence), by the ongoing auditor liaison with South Wales Police. This constrained the Welsh Government in the range of actions that it could take from the autumn of 2012 until early in 2014, when South Wales Police confirmed that it did not intend to commence a criminal investigation as it was a matter under consideration by the Serious Fraud Office.
- 4.11 On 7 February 2013, Mr Huw Lewis, the then Minister for Housing, Regeneration and Heritage announced via an Assembly Written Statement the suspension of RIFW activities. This brought the pause on new investment activities, which had been imposed upon the Fund in October 2012, into the public domain.
- 4.12 The October 2012 decision of the Welsh Government to pause RIFW's operations had an immediate impact on the RIFW Board's ability to transact business, in part because the decision was not publicly communicated until the Ministerial Statement of February 2013. At its April 2013 Board meeting, the Board noted its concern regarding the public handling of the pause and its potential impact on the Fund's reputation and operation. The former RIFW Board members sought to maintain the viability of the investment pipeline as best as could be achieved in the circumstances. We acknowledge that RIFW and its advisors were restricted in the actions they could take in managing the Fund's investment pipeline or disposing of the Fund's remaining property assets during the pause.

Two internal reviews were commissioned by the Welsh Government in February 2013 into the Fund's governance arrangements and professional advice provided to the RIFW Board

- 4.13 On 7 February 2013, the Minister also announced the launch of two Welsh Government reviews into RIFW's activities. These two reviews were:
- a a review of RIFW's governance arrangements, conducted by Mr Gilbert Lloyd; and
 - b an independent peer review of the professional advice provided to the RIFW Board, conducted by Deloitte.

- 4.14 We are satisfied that the Welsh Government's decision to commission these two independent reviews was reasonable. Their intention was that the reviews would, if appropriate, facilitate lifting the Ministerial suspension of RIFW's activities. The Welsh Government agreed that the results of both reviews would be shared with the Auditor General, and the terms of reference were also discussed with the Auditor General at the outset. Appropriate safeguards were put in place to maintain the integrity of evidence being collected by the two Welsh Government reviews and the Wales Audit Office study.
- 4.15 In July 2013, the incoming Minister for Housing and Regeneration, Mr Carl Sargeant, confirmed that the moratorium on RIFW activities remained in place. Officials recognised, however, that the ongoing uncertainty could potentially lead to RIFW's resources (in particular its EU JESSICA funds) remaining unused for regeneration purposes. The Welsh Government kept WEFO well informed of progress on all of these matters, to help allay concerns over the impact of the various reviews into RIFW activities.

In response to the emerging findings from the two internal reviews into RIFW's activities, in October 2013, the Welsh Government announced its intention to take direct control of the Fund

- 4.16 On 18 October 2013, in response to the two ongoing internal reviews and the emerging findings of the Auditor General's value for money study, and after consulting with the RIFW Board; the Welsh Government announced its intention to take direct control of RIFW. The Minister informed Assembly Members that the Welsh Government's Housing and Regeneration Department would now assume direct responsibility for the Fund and for investment processes. The announcement confirmed that RIFW as it was currently constituted would close immediately. In order to facilitate a smooth transition to ministerial control, the Welsh Government sought the agreement of the five existing Board members to resign in order that control of the Fund could revert to Welsh Ministers. As an interim measure, two Welsh Government officials have been appointed to the RIFW Board with a clear remit to:
- a take legal steps to ensure RIFW's operations were placed under the direct control of Welsh Ministers;
 - b oversee the continuing contract with RIFW's Fund Manager, Amber; and
 - c take all necessary action to safeguard the funds vested in RIFW and to minimise any further costs incurred.

As explained in [paragraph 2.8](#), at present, the RIFW Board members' legal responsibility continues to be to the RIFW LLP, not to Welsh Ministers.

- 4.17 The Welsh Government's primary intention in making this announcement was to safeguard projects in the RIFW pipeline which could potentially make a timely contribution to the regeneration of Welsh communities. The timing of this decision allowed resources currently on hold within RIFW to be made available to other appropriate regeneration projects across communities in Wales, whilst also safeguarding the investment projects in the existing pipeline. Specifically, the Housing and Regeneration Department confirmed that it would make arrangements to ensure that the investment agreed by the RIFW Board in October 2012 (shortly before the pause in investment activities) to support Neath town centre regeneration, would proceed as planned.
- 4.18 Due to the pause in RIFW activities, both the Welsh Government and WEFO had significant concerns as to whether the ERDF funds within RIFW could be fully invested by the December 2015 deadline. For these reasons and to protect the ERDF, on 7 November 2013, RIFW agreed to repay its £25 million ERDF grant funding to WEFO which allowed the funds to be available for investment elsewhere. The ERDF repayment was made to WEFO in two instalments, firstly £24 million in late November and then £1 million in early December 2013. Whilst both the Welsh Government and WEFO were aware and conscious of the possible breach of state-aid rules through the land sale process, this has not affected the decision to repay to WEFO £25 million from RIFW funds.
- 4.19 In our view, the Welsh Government handled the issues surrounding RIFW as carefully and sensitively as it could when it assumed direct control of the Fund's activities from the former Board. The Welsh Government made amendments to the RIFW management arrangements to enable the Welsh Government to assume direct responsibility. In order to continue working towards achieving the Fund's regeneration objectives, Welsh Government officials rapidly commenced due diligence of RIFW's investment pipeline and activities whilst maintaining, as far as possible, 'business as usual' for the live projects within the pipeline. The due diligence was necessary to help Welsh Government officials gain a better understanding of the contractual arrangements, suitability for investment and position of the RIFW pipeline projects which they had taken over from the former RIFW Board members. The due diligence exercise was completed in the first half of 2014 and provided some initial assurance to the Welsh Government that the pipeline projects were suitable for investment, although further work is still required before investment decisions can be made.

- 4.20 The authors of the two independent reviews commissioned by the Welsh Government for use in its internal review of the Fund did not fact check their draft reports with the RIFW Board and its advisors before providing them to the Welsh Government. Subsequently, the Welsh Government sought to 'fact check' the draft Deloitte and Gilbert Lloyd reports, prior to them being provided to the Auditor General to help inform his study. This was achieved for the Gilbert Lloyd report but limitations upon distribution to, and liability in relation to, third parties (which formed part of the contractual terms under which Deloitte produced their report) restricted fact checking of the Deloitte report. Accordingly, the Deloitte report is of less audit value and we have not sought to place reliance upon it, although we note that its findings in respect of RIFW's handling of the asset disposal process and the quality of professional advice that the Board received are broadly aligned with our own.
- 4.21 Overall, we are satisfied that the Welsh Government dealt appropriately with the exceptionally complicated situation that it was faced with in the autumn of 2012, involving a range of private and public-sector stakeholders. It took proactive measures to help safeguard the public purse as well as RIFW's regeneration objectives and sought to engage with the Auditor General and his study team in an open and constructive manner throughout the course of his study.

Appendices

Appendix 1 – Audit methods

Appendix 2 – Timeline of key events

Appendix 3 – Summarised valuations of the RIFW land and property portfolio sold to SWLD

Appendix 4 – Summarised conclusions from the District Valuer's report and valuation brief

Appendix 5 – The Nolan principles of conduct in public life



Appendix 1 - Audit methods

The scope of our work

In March 2012, the Auditor General was contacted by an Assembly Member, Byron Davies AM, who expressed concerns regarding the property sale to SWLD.

In order to respond to the correspondence from the Assembly Member, Wales Audit Office staff acting on the Auditor General's behalf made several preliminary enquiries. These enquiries did not provide an appropriate level of assurance in respect of the governance, propriety and value for money of the land sale, and identified some additional areas of potential audit concern.

In October 2012, the Auditor General therefore decided to widen the scope of his initial review, which had focused upon the sale transaction itself, into a value for money study and to report publicly on the findings. The study's terms of reference encompassed RIFW's aims, governance and operation, including its investment business, together with the effectiveness of the Welsh Government's oversight of RIFW.

The Auditor General's study set out to answer the question:

'Can the Welsh Government demonstrate that the creation and operation of the Regeneration Investment Fund for Wales (RIFW) safeguard the public purse and optimise value for money?'

The study was conducted on behalf of the Auditor General by staff of the Wales Audit Office, assisted by specialist forensic audit support from Grant Thornton. The Auditor General also commissioned professional valuation advice from the District Valuer. The study was conducted using statutory powers under the Government of Wales Acts 1998 and 2006.

Fieldwork was phased to ensure that information from a document review could be used to inform interviews. Undertaking fieldwork elements in sequence rather than in parallel extended the elapsed time for the study.

Because of the study's complex and sensitive nature, throughout the project we regularly:

- paused and reviewed progress;
- reviewed findings and scrutinised evidence; and
- tested hypotheses and challenged conclusions.

The study drew on:

- document and literature reviews;
- interviews, face-to-face and by telephone;
- exchange of correspondence;
- observation of a RIFW Board meeting;

- questionnaire surveys of marketing contacts and leasehold tenants;
- analysis of financial information and calculation of the net present value of deferred payments;
- an 'Asset Realisation Report' (December 2012) and a 'Supplemental Report' (January 2015), both of which were prepared by Amber specifically to assist the Auditor General's study team;
- an independent valuation of the land and property portfolio by the District Valuer Services of the Valuation Office Agency (the District Valuer) commissioned by the Auditor General ([Appendix 4](#)); and
- where appropriate, results of reviews commissioned by the Welsh Government.

Document reviews

We have reviewed a wide range of documents relating to RIFW's establishment, its activities (including investments and property disposals) and also its governance arrangements. Predominantly, documents have been provided by the Welsh Government and by Amber, the Fund Manager; and we have also seen material provided by LSH and SWLD. However, we cannot be certain that we have reviewed all of the documentation relevant to RIFW and to the scope of our review. In particular, a key meeting of the RIFW Board, held over the telephone on 28 April 2011, does not appear to have been minuted.

In addition, we have examined the contents of the reports of independent reviews commissioned by the Welsh Government. These were:

- an internal review of RIFW's governance arrangements (the Lloyd Report)⁸⁶; and
- an expert peer review of professional advice provided to the RIFW Board, particularly in relation to the sale transaction (the Deloitte report)⁸⁷.

Interviews

The study's complexity was reflected in the range and number of interviews required. The interviews were scheduled in sequence to ensure that later interviews could be informed by information gathered from earlier ones. The necessity for this extended the elapsed time required to complete the interview programme. Several interviewees were interviewed more than once as the study progressed. Specifically, we interviewed Welsh Government officials involved in establishing RIFW, all of the RIFW Board members and advisors to the RIFW Board, and the purchaser's representative involved in the portfolio transaction (the ultimate beneficial purchaser, Sir Stanley Thomas, declined to be interviewed).

⁸⁶ **Regeneration Investment Fund for Wales, Governance Arrangements – Internal Review**; Gilbert Lloyd, April 2013 (the Lloyd Report).

⁸⁷ **Welsh Government peer review – RIFW asset portfolio disposal**: Deloitte, August 2013 (the Deloitte Report).

Independent valuation advice

Because the sale was a sale by private treaty, without open marketing, the Auditor General commissioned professional valuation advice from the District Valuer Services of the Valuation Office Agency (the District Valuer).

Valuations were provided as at:

- 1 October 2009 – the King Sturge valuation date;
- 10 March 2010 – the date of transfer from the Welsh Government to RIFW;
- 1 March 2011 – the date of the RIFW Asset Realisation Plan approved by the RIFW Board as part of the First Business Plan;
- 2 March 2012 – legal sale completion date for 14 of the assets sold as a portfolio to SWLD; and
- 1 March 2013 – legal sale completion date for the final asset sold (Brackla) sold as a portfolio to SWLD.

In addition, the District Valuer provided professional advice in relation to:

- the RIFW Asset Realisation Plan, marketing the assets and the sale process;
- the terms of overage provisions included within the sale contract in relation to two of the properties;
- valuations provided to the Welsh Government in 2009 (by King Sturge); SWLD in 2012 (by Savills); and RIFW in 2014 (by Colliers); and
- the ITT documentation relating to the selection of the Fund Manager and the Investment Manager and also the respective agreements under which they were appointed.

Questionnaire survey of marketing contacts and leasehold tenants

We surveyed organisations and individuals with whom LSH had contact in relation to marketing the RIFW land and property assets, using a postal survey. We provided the questions in advance to LSH and they provided named individuals to whom the questionnaire was addressed. The questions were directed towards establishing the nature of the contact, the property or properties that were of interest and the nature of LSH's response to the interest.

We also surveyed existing leasehold tenants using a postal questionnaire to establish whether they were aware that the property would be offered for sale, if they had expressed any interest in buying the freehold interest, and how any such enquiries were handled.

Draft report clearance

We followed our usual 'clearance' process whereby we seek confirmation from all organisations and individuals referred to in our report that:

- the facts in the report are accurately stated;
- all material facts are included; and
- the facts are fairly presented.

It is important to note that only the facts within the report are 'cleared' in this way; the conclusions and recommendations contained in the report remain those of the Auditor General.

Appendix 2 - Timeline of key events

RIFW Timeline

January

2008

Initial discussions between Welsh Government officials and the European Investment Bank about establishing a JESSICA fund in Wales.

October

Ministerial approval in principle for RIFW JESSICA project, to include funding in cash and also land and property assets to be used for funding regeneration investment projects.

2009

February

The Welsh Government established a project board to co-ordinate setting up a JESSICA fund.

June

The Welsh Government begins to identify land and property assets for potential transfer to RIFW.

July

The Welsh Government instructs King Sturge to value 23 assets for potential transfer to RIFW in order to ensure that RIFW will be able to generate enough cash from sales to meet its long-term investment objectives, above that which is required for ERDF match-funding.

August

The Welsh Government placed an advert in the Official Journal of the European Union announcing that it will seek investment and fund managers for RIFW.

October

King Sturge valuation date for total of 23 property assets proposed for transfer to RIFW at between £29.831 million based on existing use and £35.581 million including 'hope value' to reflect the market value of the assets because of potential for future increases in value from changes in planning or development.

December

RIFW LLP established and registered at Companies House. Welsh Ministers are the LLP members.

2010

February

The Welsh Government invited tenders from companies to support the RIFW Board as investment and fund manager. Welsh Government officials make the final selection of assets to be transferred to RIFW in order to provide a mixed portfolio, some of which will be more or less attractive to the marketplace. The Welsh Government instructs King Sturge to value Brackla (not included on original list of assets) as at the same October 2009 date as the other assets. The aggregate value of the 18 assets actually transferred to RIFW provided by King Sturge was between £20.55 million (existing use) and £26.3 million (including 'hope value') as at October 2009.

March

A Business Plan for obtaining £25 million of EU ERDF funding is prepared for the Welsh Government by a firm of consultants and submitted to WEFO. The Business Plan envisages property disposals beyond the first phase of the Fund, to end Dec 2015. £55 million investment Fund established, comprising £25 million EU ERDF (to be invested by end Dec 2015) plus £9.4 million cash and £20.6 million property from the Welsh Government. ERDF match-funding requirement is £15.4 million. First meeting of RIFW 'shadow' Board. Formal transfer date of property assets to RIFW (although legal registration of titles was not completed until later). A notional 'transfer value' was agreed at £20,627,000, based on existing usage and excluding 'hope value'.

King Sturge confirm to the Welsh Government that the aggregated valuations of the 18 assets transferred to RIFW total between £20,650,000 and £26,400,000. The higher figure includes 'hope value' and reflects the market value of the assets. These totals include £100,000 of property which was not actually transferred. Adjusted totals for the 18 sites actually transferred to RIFW are £20.55 million and £26.30 million.

City of Cardiff Council withdraw their draft Local Development Plan following criticism of its lack of greenfield development.

November

Deputy Minister for Regeneration and Housing invites Councillor Chris Holley to join the RIFW Board as an external member. An offer of £185,000 is received for part of the Cogan Hall Farm site which is accepted and the sale is completed in November 2011. RIFW retains the remainder of the site which was not included in the portfolio sale.

December

Formal execution of LLP Members Agreement governing operation of RIFW. Fund Manager (Amber) and Investment Manager (LSH) formally appointed, following competitive tender, to manage RIFW's day-to-day business. Amber becomes a non-voting member of the LLP.

2011

January

RIFW Board achieves full planned composition, having met as a Shadow Board since March 2010.

An initial Business Plan is presented to the RIFW Board, indicating a phased disposal of the assets. A possible portfolio sale is not included as an option. A total 'realisation value' of £28.425 million is quoted, based on LHS's opinions of aggregated sale returns from phased disposals; not a full valuation.

2011

March

Initial cash offer for entire portfolio (including assets not transferred to RIFW) received from GST Investments for £23.0 million and reported to the RIFW Board at the Mar 2011 Board meeting.

LSH receive an initial expression of interest from Rightacres proposing a portfolio sale for £17.47 million plus overage on five sites. The interest did not progress to an offer. Rightacres' expression of interest is not reported to the Mar 2011 Board meeting.

RIFW Board approves RIFW First Business Plan, including preferred option for a phased disposal of all assets by end 2014 to yield a 'realisation value' of £24.935 million. The Business Plan acknowledges the possibility of a portfolio sale.

The RIFW Board is notified of the initial offer from GST Investments for the whole portfolio. Board Member Mr J Geen declares he is likely to have a conflict of interest and leaves the meeting.

To ensure the assets are readily marketable and saleable, the RIFW Board commissions legal due diligence on the assets transferred to them, under a Welsh Government framework agreement.

April

LSH internal email acknowledging that market exposure of the portfolio was limited, to responses to inquiries. The Portfolio Transaction Report prepared for the Board by Amber states that the portfolio has been discussed with the most likely potential purchasers.

Amber and LSH stage public sector focused events in Llandudno, Swansea and Merthyr to promote RIFW's investment activity.

Unminuted meeting of the RIFW Board held as a telephone conference. A Portfolio Transaction report prepared for the Board compared the GST Investments offer with an initial expression of interest from Rightacres, also received in early March. Both are compared with the 'transfer value' of the assets (without 'hope value') rather than the asset realisation value in the RIFW Business Plan. The Board decided to progress with the GST Investments offer for a portfolio sale. An immediate departure from the agreed RIFW Business Plan which favoured a phased disposal.

A separate offer of £60,000 is received for part of the Brackla site. The sale is completed in November 2011. The remainder of the site was included in the portfolio sale.

May

Amber internal note that no formal marketing of the portfolio has been undertaken but that LSH considers that all likely potential purchasers have been 'informally canvassed'.

In papers for a RIFW Board meeting convened to specifically discuss GST Investments' offer, Amber and LSH recommend to the RIFW Board that they accept the GST Investments offer at £22 million with overage on two sites, Monmouth and Lisvane. The paper to the Board states that the portfolio has not been formally marketed. The purchaser's representative had previously informed the Board (in April) that including overage on the Lisvane site would result in a reduced offer of £21 million. The Board minutes record a resolution to accept an offer of £23 million, including overage on terms more favourable to RIFW than the recommendation. The portfolio sale should be on a 'warts and all' basis.

GST Investments respond with an offer of £21 million in instalments with overage on Monmouth and Lisvane. LSH responded that £22.5 million in instalments with overage on Lisvane and Monmouth would be acceptable, subject to RIFW Board approval.

June

Sale of portfolio of 18 land and property assets to GST Investments for £22.5 million, payable in instalments and with overage clauses on terms less favourable to RIFW than the previous resolution is agreed in principle by the RIFW Board, although insufficient members were present for a valid resolution. The sale is benchmarked against the 'transfer value' of £20.6 million, which reflected the assets' existing use as at Oct 2009.

July

Amber and LSH stage private-sector focused events in Swansea and Cardiff to promote RIFW's investment activity.

August

Departmental restructuring within the Welsh Government resulting in responsibility for RIFW transferring from the Department for Economy and Transport (now the Department for the Economy, Science and Transport) to the Sustainable Futures department.

November

LSH obtained a quotation to obtain a full valuation of the RIFW portfolio and forwarded it to Amber. However, no further action was taken.

Amber and LSH stage a private-sector-focused event in Conwy to promote RIFW's investment activity.

January

2012

Valid resolution of RIFW Board to proceed with portfolio sale of 15 assets for £21.7 million, payable in instalments and terms of sale finalised, which included overage clauses in relation to two sites. Purchaser (formerly GST Investments) identified as South Wales Land Developments Limited (SWLD), a Guernsey-based company established for the purposes of the transaction. Two assets deemed to be of little value were excluded from the sale; part of one asset included in the sale was sold separately; and part of one asset was excluded because RIFW did not own it.

Savills provides a valuation to SWLD valuing the assets subsequently sold to SWLD at between £22.2 million and £24.4 million. Applying a portfolio discount values the sale transaction at between £17.6 million and £20.2 million.

February

Sale contracts exchanged for a portfolio of 15 assets for a total of £21.7 million, including overage agreements for two sites that provide for RIFW to share in any future value uplift. The final overage terms are less favourable to RIFW than those which the Board agreed. A deposit of £2.17 million is paid. Remaining balance to be paid in three instalments over two years without interest.

WEFO permits investment scheme proposals to be eligible for ERDF funding with a retail component above 50 per cent, increasing the range and number of potential investment schemes that may apply for ERDF funding via RIFW.

March

Portfolio sale of 14 assets completed for £15.7 million, plus overage on two sites at Lisvane and Monmouth. Sale of 15th asset, for £6 million, is conditional. First instalment payment of sale proceeds from SWLD to RIFW, £10.33 million.

SWLD engage LSH to manage the sites purchased from RIFW in South Wales, including lettings, planning promotion, marketing and sales.

Mr Byron Davies AM tables a written question on RIFW to Mr Huw Lewis AM (then Minister for Housing Regeneration and Heritage) raising concerns about the sale of RIFW's assets.

Ministerial answer to Assembly questions about the RIFW asset portfolio sale.

An Assembly Member, Mr Byron Davies AM, sends an e-mail to the Auditor General expressing initial concerns about the asset portfolio sale transaction.

July

SWLD sells on the Aberdare and Bangor sites purchased from RIFW.

August

ERDF investment compliance is confirmed for RIFW's first investment project in Neath.

October

RIFW Fund Manager (Amber) approves first investment project in Neath.

City of Cardiff Council publishes its preferred Strategy for Local Development, reconfirming potential for residential development on the Lisvane greenfield site sold by RIFW, with overage.

The Auditor General announces full value-for-money study of RIFW. The Welsh Government suspends RIFW's activities.

2013

February

The Welsh Government publicly announces the pause to RIFW's activities, which had been in place since October 2012 and also announces two independent reviews, of governance arrangements and of professional advice.

March

Sale of final site, Brackla, to SWLD completed for £6 million, once pre-conditions of sale are met; totalling £21.745 million payable in instalments for portfolio of 15 sites, plus potential overage returns from two sites at Lisvane and Monmouth.

In March 2010, the aggregated market value of the assets sold to SWLD had been confirmed as £25.58 million, not including a portfolio discount, any adjustments arising from the inclusion of overage clauses or potential overage receipts.

The District Valuer has provided the Auditor General with a market value of the RIFW assets sold as a portfolio to SWLD of £30.9 million, excluding any potential future receipts from the overage clauses agreed in relation to two sites.

Second instalment payment of sale proceeds from SWLD to RIFW, £5.0 million. This payment would have been adjusted to £3.22 million if the sale of Brackla had not been completed.

April

RIFW report to WEFO that 62 potential investment projects are at various stages of development; including 14 discontinued, 38 in early evaluation, nine at expression of interest stage, and one approved with funding in place.

Results of the independent review of RIFW's governance arrangements (the Lloyd Report) were reported to the Welsh Government.

July

The (then) Minister for Housing and Regeneration, Mr Carl Sargeant confirms that the pause on RIFW's activities remains in place.

August

Results of an independent review of professional advice provided to the Fund, conducted by Deloitte, were reported to the Welsh Government.

September

The deposit Local Development Plan for Cardiff is agreed by Cabinet for consultation. It includes residential development on the Lisvane site sold by RIFW to SWLD.

SWLD submits a planning application for 1,200 new homes on the Lisvane site, the 'Churchlands development'. Under the terms of sale agreed between RIFW and SWLD, granting planning permission would trigger an overage payment to RIFW based upon a proportion of any resulting increase in value.

October

The RIFW Board commissions a valuation of the assets sold to SWLD from Colliers International LLP (Colliers).

The Welsh Government's Housing and Regeneration Department takes direct control of RIFW in order to allow the activities of the Fund to be brought back under direct Ministerial control. The existing RIFW Board members resign and are replaced by two Welsh Government officials as an interim measure.

November

RIFW agrees to repay £25 million of EU ERDF funding to WEFO to avoid the risk of unspent funds being returned to the EU. Existing RIFW investment projects will be funded wholly by RIFW.

January

SWLD sells on part of the Pyle site purchased from RIFW.

February

Colliers value the assets sold as a portfolio to SWLD at the time of the sale, with overage provisions covering two sites, at £19.4 million.

Monmouthshire County Council formally adopts its Local Development Plan which includes the site sold by RIFW within its allocation for mixed-use residential and employment development. Under the overage clause which was part of the terms of sale to SWLD, the site's inclusion within an approved Local Development Plan is a trigger event for payment of an additional sale receipt to RIFW based upon a proportion of any increase in the site's value.

March

Final (third) instalment payment of sale proceeds from SWLD to RIFW, £4.24 million. This payment would have been cancelled if the sale of Brackla had not been completed.

May

SWLD submits an outline planning application to Monmouthshire County Council for mixed-use development on the site sold by RIFW.

June

City of Cardiff Council approves the deposit Local Development Plan for submission to the Welsh Government for independent examination in early 2015. The Lisvane site is included in an area earmarked for residential development, which could potentially result in an overage payment to RIFW of a share of any uplift in the site's value.

The Auditor General's Report covers events to the end of June 2014 in detail.

December

Monmouthshire County Council grants planning consent for mixed-use development (370 dwellings and 6.5 hectares of employment) on the site sold by RIFW, a trigger event for payment of additional sale receipts to RIFW under the overage clause which was part of the terms of sale to SWLD.

SWLD submits an alternative planning application to City of Cardiff Council for development on the Lisvane site.

2014

2015

January

'Churchlands development' planning application by SWLD for the Lisvane site is refused by City of Cardiff Council. SWLD appeals against the decision. The appeal is unlikely to be decided before Cardiff's Local Development Plan is adopted, estimated to be in Sep 2015.

April

Onward sale by SWLD of Monmouth site to a developer for £12 million. Under the sale terms agreed between RIFW and SWLD, an onward sale can result in an overage payment.

December

Date by which £25 million of EU ERDF funding to RIFW must be committed and paid to regeneration investment projects to avoid being returned to the EU. RIFW needed to have invested £15.4 million in regeneration projects to draw down the full-amount of EU ERDF funding. The ERDF funds were transferred from RIFW to WEFO in Nov 2013 to be committed elsewhere and avoid repayment to the EU.

Appendix 3 - Summarised valuations of the RIFW land and property portfolio sold to SWLD

Please note that the valuations in the table below were provided at various times by different valuers and for different purposes, using a variety of valuation approaches and assumptions. Therefore, they are not directly comparable. Where valuations identify an assumption about the presence of an overage clause, it is taken account of in the valuation. However, any potential future receipts arising from such a clause, if triggered, are excluded from the valuation.

Asset	Portfolio sale price to SWLD, sale price for Brackla and overage baselines for Lisvane and Monmouth, at completion; 2 March 2012 (1 March 2013 for Brackla).	District Valuer market valuations (which reflect any discernable 'hope value') as at sale completion, 2 March 2012 (1 March 2013 for Brackla) and reflecting inclusion of overage terms (but not receipts), which were known at the valuation date, for the Lisvane and Monmouth sites.	District Valuer portfolio sale valuation at completion. Discounted by 15 per cent, and reflecting inclusion of overage terms (but not receipts), which were known at the valuation date, for the Lisvane and Monmouth sites.	King Sturge existing use value as at 1 October 2009	King Sturge market valuations as at 1 October 2009 (which includes 'hope value' identified on Lisvane, Pyle, Towyn, St Asaph and Abergele sites), adjusted to exclude land not transferred to RIFW and also assets not sold to SWLD.
Imperial Park, Newport		£3,700,000			£5,100,000
Lisvane, Cardiff	£1,835,000	£10,500,000	£8,925,000	£1,835,000	£6,100,000
Wrexham Industrial Estate		£435,000			£390,000
Llantrisant Business Park		£285,000			£330,000
Upper House Farm, Rhoose		£3,250,000			£2,700,000
Goetra Uchaf Farm, Bangor		£3,400,000			£1,500,000
Llanfairpwll, Anglesey		£175,000			£150,000
Ty Draw Farm, Pyle		£450,000		£100,000	£450,000
Mayhew Foods site, Aberdare		£430,000			£300,000
Wonastow Road, Monmouth	£990,000	£3,850,000	£3,272,500	£990,000	£990,000
Towyn Way East, Towyn		£850,000		£155,000	£735,000
Pen y Bryn, St Asaph		£750,000		£230,000	£700,000
St Georges Rd, Abergele		£1,300,000		£90,000	£175,000
Llandudno Junction		£1,000,000			£520,000
Brackla Industrial Estate, Bridgend	£6,018,029	£6,000,000	£5,100,000		£5,440,000
	£21,747,498	£36,375,000	£30,918,750	£3,400,000	£25,580,000

RIFW Asset Realisation Plan assuming phased disposal, March 2011	Savills Market Valuations (which will include 'hope value' at January 2012. Monmouth and Lisvane valuation ranges reflect the proposed overage terms (but not receipts) that were known at the valuation date.		Savills portfolio sale valuation at January 2012. Discounted by 20 per cent. Range includes hope value and reflects the proposed overage terms (but not receipts) for Monmouth and Lisvane that were known at the valuation date.	Colliers market valuations at exchange of contracts, 18 February 2012. The Colliers market values listed below for Monmouth and Lisvane ignore the known overage provisions that were included within the sale contracts.	Colliers portfolio sale valuation at exchange, February 2012, discounted by 10 per cent and reflecting the proposed overage terms (but not receipts), which were known at the valuation date, for the Monmouth and Lisvane sites.
£4,000,000	£3,500,000	£4,000,000		£3,625,000	
£2,500,000	£3,500,000	£4,000,000		£2,265,000	
£600,000	£219,000	£310,250		£750,000	
£200,000	£300,000	£320,000		£350,000	
£3,000,000	£3,440,000	£3,950,000		£2,200,000	
£3,000,000	£1,850,000	£2,000,000		£2,200,000	
£200,000	£100,000	£125,000		£300,000	
£100,000	£170,000	£210,000		£1,300,000	
£300,000	£300,000	£350,000		£295,000	
£1,500,000	£3,600,000	£4,000,000		£2,500,000	
£155,000	£362,000	£400,000		£260,000	
£230,000	£200,000	£250,000		£280,000	
£150,000	£300,000	£400,000		£350,000	
£1,000,000	£735,000	£825,000		£475,000	
£7,500,000	£3,600,000	£4,300,000		£5,075,000	
£24,435,000	£22,176,000	£25,440,250	£17,740,800-£20,332,200	£22,225,000	£19,400,000

Appendix 4 - Summarised conclusions from the District Valuer's report and valuation brief

Summarised conclusions

The District Valuer Service (DVS) was instructed by the Auditor General to review the property portfolio sale values achieved by the Regeneration Investment Fund for Wales (RIFW). The date of sale for the RIFW assets is taken as the date of legal completion, which is 2 March 2012 (except for Brackla which, completed on 1 March 2013). Valuations at a further four dates were also requested.

The DVS was also asked to consider the valuation advice provided by King Sturge (in their report of 4 December 2009 and King Sturge's supplementary letter of 24 March 2010) and a further sale review undertaken for RIFW by Colliers International LLP and reported on 25 February 2014.

The properties being considered within this report are listed in the table below:

DVS ref	Site Address	
1	Imperial Park, Newport	Sale to SWLD, completed 2 March 2012.
2-4	Llwynypia, Church House and Maerdy farms, Lisvane, Cardiff	Sale to SWLD, completed 2 March 2012.
5	Wrexham Industrial Estate	Sale to SWLD, completed 2 March 2012.
6	Llantrisant Business Park	Sale to SWLD, completed 2 March 2012.
7	Upper House Farm, Rhoose	Sale to SWLD, completed 2 March 2012.
8	Cogan Hall Farm, Penarth	Part sold separately, part retained by RIFW.
9	Garth Park, Talbot Green	Not sold to SWLD. Retained by RIFW.
10	Goetre Uchaf Farm, Bangor	Sale to SWLD, completed 2 March 2012.
11	Ty Mawr, Llanfairpwll, Anglesey	Sale to SWLD, completed 2 March 2012.
12	Ty Draw Farm, Pyle	Sale to SWLD, completed 2 March 2012.
13	Mayhew Foods site, Aberdare	Sale to SWLD, completed 2 March 2012.
14	Anchor Way, Penarth	Not sold to SWLD. Retained by RIFW.

DVS ref	Site Address	
15	Wonastow Road, Monmouth	Sale to SWLD, completed 2 March 2012.
16	Towyn Way East, Towyn	Sale to SWLD, completed 2 March 2012.
17	Pen y Bryn, St Asaph	Sale to SWLD, completed 2 March 2012.
18	St Georges Rd, Abergele	Sale to SWLD, completed 2 March 2012.
19	Waenfynydd Farm, Llandudno Junction	Sale to SWLD, completed 2 March 2012.
20	Brackla Industrial Estate, Bridgend	Part sold separately, remainder sold to SWLD, completed 1 March 2013.

I firstly question whether (purely from a “best sale value” viewpoint, and unaware of Governmental strictures) the placing of twenty very different assets with the RIFW was the best way of realising the monies required to unlock European investment match funding. The sites had very different marketing requirements, some of which needed very careful focus (and time) to unlock their full potential values. There are plenty of examples of other public bodies in Wales and the rest of the UK disposing of some very complex and valuable development sites through the use of a carefully managed marketing process, and such sites are dealt with on a site by site, and not portfolio, basis.

There are very significant differences between many of our valuations and the sale prices achieved by RIFW. At the sale completion date of 2nd March 2012 (1st March 2013 for Brackla) these differences amount to a total variance of just over £14.637 million (DVS cumulative valuation = £36.375 million as opposed to a sale receipt of just under £21.748 million). This is, in my opinion (which is based on this review), as a result of disposal and marketing strategy adopted by RIFW and its advisors. There may have been other factors (such as the fund management costs) which also impacted upon the disposal decision making but the scope of our review does not identify any further specifics.

In my opinion, based upon this review, the overall RIFW disposal process did NOT secure the best sale receipts achievable at the time of sale (i.e. we cannot confirm the deal reached with South Wales Land Developments as satisfying “best value” sale criteria). For the avoidance of doubt, I believe alternative approaches to disposal and marketing of the RIFW assets (as outlined within my report) would have yielded greater overall sale receipts. Finally, the sale terms agreed with the purchaser also did not sufficiently protect the interests of the RIFW (or, ultimately, the taxpayer) as it is clear that wider and more careful use of overage clauses would have almost certainly already secured (in light of the sites already re-sold by South Wales Land Developments) further receipts in favour of the public purse.

In fairness to RIFW and its advisors the DVS values reported assume “proper marketing” that in some cases will extend to site planning promotion and/or co-operative working arrangements with developers, both of which (in the case of the largest and most valuable sites) can take considerable time, resources and perseverance. So, as already mentioned, one area your review needs to consider is whether some of these larger and more valuable sites should/could have been dealt with differently (i.e. longer term value capture) and whether more targeted marketing of the remaining assets could still have achieved the sale receipts that RIFW was tasked with generating. Whilst it is clear (in my opinion) that there were opportunities for better sale results to be achieved, the practical operational challenges facing RIFW certainly hindered RIFW’s ability to achieve the full market value of some RIFW owned sites.

I have stated my view that the disposals could have better managed and received better market exposure. However, in the case of some of the largest and potentially most valuable sites (e.g. Lisvane and Monmouth, which are not suited to a conventional upfront sale) realising their full value is a process that may take some time and resources, which may include the use of specialist master-planners and/or co-operative arrangements with a developer (or consortium of developers).

Finally, your instructions sought our views on the value of the subject assets sold as a single portfolio, should this be any different to the cumulative value of the individual assets. Clearly, my views in respect of “prudent lotting” highlight my opinion that sale as a single portfolio will result in a lower overall value. There are many reasons for this but I highlight two of the most prominent factors below:

- **A buyer’s market** – there are far fewer potential purchasers who can raise £50 million (especially in the current market) than those that can raise £500,000. The economic law of supply and demand states that where supply remains fixed but demand falls (through reduced competition) then price also must fall. Prudent lotting and prudent marketing are the counters to this risk.
- **A mixed portfolio** – whilst the assets are virtually all land with some prospect of development, they vary greatly in terms of geographic location, size, end market (residential/employment), development challenges and time until development realisation. As such, every site has a market of potential buyers but these buyers vary (quite significantly in some instances) from site to site. Again, prudent lotting and prudent marketing are the counters to this risk.

In terms of the valuation variance between the cumulative value of the subject assets and their value as a portfolio, this is a difficult assessment to make because development land is not commonly transacted (especially in current market conditions) and development land sold as a portfolio even less so. I would also expect sales of development land portfolios to often occur in circumstances of greater change (e.g. distressed sales, company mergers/acquisitions, strategic investments etc.), which would make such evidence more circumstantial, and more difficult to analyse and apply.

In the case of prudently marketing the RIFW portfolio, this would need to extend beyond Wales, and be conducted on such a basis as to generate interest not only within the UK but from other investors who may be seeking such longer term development prospects in what is, in international terms, a relatively stable and attractive region for investment.

From my investigations it is not clear that this was undertaken for the RIFW assets, but if it were I would expect that a portfolio sale discount could be potentially limited to in the region of 15% (i.e. £36.375 million cumulative value reduced to circa £30.9 million). However, this is very much an investment decision for the potential purchaser and will be driven by their views on the overall risk and return equation coupled with their accounting for the costs (both actual and in terms of time) associated with realising the final portfolio value i.e. there could be large variances between the views of some investors.

In my opinion, many of the matters raised subsequent to the portfolio sale could have been avoided/mitigated by a more prudent, open and carefully managed disposal process and the inclusion of overage provisions for the majority of the assets. It is also disappointing that it appears only a minimum overall portfolio sale value was needed to satisfy RIFW's funding requirements and I am not aware of any proposals to consider alternative ways to achieve this whilst realising best value for the public purse (i.e. achieve surplus receipts for investment in other areas of public good).

Valuation brief provided by the Wales Audit Office

Aim:

To commission independent, professional valuations of a portfolio of land and property assets that was transferred from the Welsh Government to the Regeneration Investment Fund for Wales (RIFW), the majority of which have subsequently been sold to a private-sector purchaser.

These valuations will be used to inform the Wales Audit Office's audit judgements regarding the value for money obtained for the taxpayer from the activities of RIFW.

Work to be performed:

Valuations of individual assets are to be provided as at various dates (see below), together with an overall portfolio valuation on each occasion, if different from the sum of the component assets. A valuation of the assets sold as a portfolio is to be provided at the sale completion date (and current value if different) if different from the sum of the component assets.

A forensic analysis of the 1 October 2009 King Sturge reports on each asset should also be undertaken, to confirm that each of these lie within accepted valuation tolerances. This analysis should take account of contemporaneous knowledge and assumptions as well as identifying the impact on values of any changes in circumstances and in the quality or extent of information available. We also require a professional assessment of the King Sturge letter of 24 March 2010 (in which they confirmed that their October 2009 values remained extant), taking into account market conditions and any changes in relation to the assets.

Basis of valuation:

Market Value, as defined within RICS standards.

This must take into account extant planning permission, ground conditions, title and impediments etc as these existed at the various valuation dates. Whilst Market Value will take into account any development prospects, a separate comment on hope value (where applicable) will also be required.

Dates of valuation:

Valuations will also be required as at:

- the date of the transfer of the portfolio from the Welsh Government to RIFW (10 March 2010), if there were any changes that would have affected the value of the assets since the October 2009 King Sturge valuation;
- the date of preparation of the RIFW Asset Realisation Plan (ARP), March 2011, including a professional view of reasons given in the ARP for any changes since the October 2009 King Sturge valuation;
- taking account of any material changes in individual site planning status/known prospects/prevaling market knowledge at the time, to review/refresh the March 2011 Lambert Smith Hampton opinion of value to reflect the position at the sale completion date (31 January 2012, except for Brackla 1 March 2013); and
- the present day (will need to make this as 'up to date' as possible, for audit purposes) if there have been any changes that would have affected the value of the assets since the sale completion.

Logistics:

Full disclosure of available documentation relating to each site, including site conditions, tenancies etc will be provided. Where appropriate, the Wales Audit Office will arrange direct access to Welsh Government files detailing tenancy schedules, terms, review dates, liabilities and service charges etc. Any contact with the Welsh Government will be facilitated by Wales Audit Office.

The presumption will be that each site will be visited to support valuation as per RICS. Physical access to each site will be facilitated, subject to the Wales Audit Office obtaining the consent of the current owners for this. If this is not forthcoming, where possible use should be made of public rights of way.

Reporting:

The report should be addressed to the Auditor General for Wales.

Appendix 5 - The Nolan principles of conduct in public life

The Seven Principles of Public Life, known as the Nolan Principles, were defined by the First Report of the Committee on Standards in Public Life, May 1995. They are:

- **Selflessness:** Holders of public office should act solely in terms of the public interest. They should not do so in order to gain financial or other benefits for themselves, their family or their friends.
- **Integrity:** Holders of public office should not place themselves under any financial or other obligation to outside individuals or organisations that might seek to influence them in the performance of their official duties.
- **Objectivity:** In carrying out public business, including making public appointments, awarding contracts, or recommending individuals for rewards and benefits, holders of public office should make choices on merit.
- **Accountability:** Holders of public office are accountable for their decisions and actions to the public and must submit themselves to whatever scrutiny is appropriate to their office.
- **Openness:** Holders of public office should be as open as possible about all the decisions and actions that they take. They should give reasons for their decisions and restrict information only when the wider public interest clearly demands it.
- **Honesty:** Holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest.
- **Leadership:** Holders of public office should promote and support these principles by leadership and example.

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